This Preliminary Offering Circular and the information contained herein are subject to completion or amendment without notice. Under no circumstances shall this Preliminary Offering Circular constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of, the securities described herein in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction.

PRELIMINARY OFFERING CIRCULAR DATED NOVEMBER 7, 2016

NEW ISSUE **BOOK-ENTRY ONLY**

In the opinion of Orrick, Herrington & Sutcliffe LLP ("Transaction Counsel"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, the interest on the Series 2017 Bonds is: (i) excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code"), (ii) not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Transaction Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income, and (iii) excluded from adjusted gross income for purposes of personal income taxes imposed by the State of New York and The City of New York to the extent that such interest is excluded from gross income for federal income tax purposes. Transaction Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds. See "TAX MATTERS".

$1,024,385,000*
TSASC, INC.
Tobacco Settlement Bonds

$584,385,000* Fiscal 2017 Series A (Senior) **$440,000,000* Fiscal 2017 Series B (Subordinate)**

Dated: Date of Delivery **Maturity Dates: June 1, as shown on inside cover**

TSASC, Inc. ("**TSASC**") is a local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the "**State**"). TSASC is an instrumentality of, but separate and apart from, The City of New York (the "**City**").

TSASC has purchased all of the City's right, title and interest under (i) the Master Settlement Agreement (the "**MSA**") that was entered into by participating tobacco product manufacturers (the "**PMs**"), 46 states (including the State) and six other U.S. jurisdictions in November 1998 in settlement of certain smoking-related litigation and (ii) the Consent Decree and Final Judgment related thereto (the "**Tobacco Assets**"), including the City's right to receive certain annual payments to be made by the PMs under the MSA (such payments and rights, as more fully described herein, the "**Tobacco Settlement Revenues**" or "**TSRs**").

The Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior) (the "**Series 2017A Senior Bonds**") and the Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate) (the "**Series 2017B Subordinate Bonds**" and, together with the Series 2017A Senior Bonds, the "**Series 2017 Bonds**") are to be issued pursuant to an Amended and Restated Indenture, dated as of November 1, 2016 (the "**Indenture**"), between TSASC and The Bank of New York Mellon, as trustee (the "**Indenture Trustee**"), and a Series Supplement (as defined herein) thereto, for the purpose of refunding all of TSASC's outstanding indebtedness. The Series 2017A Senior Bonds will be senior to the Series 2017B Subordinate Bonds in payment priority under the Indenture, as described herein. The Series 2017 Bonds, together with any Additional Bonds and Junior Bonds (each defined herein) issued under the Indenture, are referred to herein as the "**Bonds**".

The Bonds are limited obligations of TSASC and are payable solely from the Pledged TSRs (as hereinafter defined) and the other collateral pledged under the Indenture. The "**Pledged TSRs**" are the right, title and interest of TSASC in and to 37.40% of the Tobacco Assets. TSASC has no financial assets available for payment of the Bonds other than the Pledged TSRs and the other collateral pledged under the Indenture. The right of the Indenture Trustee to receive Pledged TSRs is equal to and on a parity with, and is not inferior or superior to, the right of TSASC to receive the portion of the TSRs that have not been pledged under the Indenture (the "**Unpledged TSRs**").

The amount of Pledged TSRs received depends on many factors, including future domestic cigarette consumption, the financial capability of the PMs and the domestic tobacco industry, litigation generally, including litigation challenging the MSA and related state statutes, and federal, state and local regulations affecting the domestic tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments and credits, including pursuant to the NY NPM Settlement relating to the NPM Adjustment under the MSA (as such terms are defined herein), which may be material.

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

The Series 2017 Bonds are subject to optional and mandatory redemption and the Series 2017B Subordinate Bonds are also subject to extraordinary payment, all as described herein. The Series 2017B Subordinate Bonds are Turbo Term Bonds that mature on June 1 in the years set forth on the inside cover but are subject to possible earlier mandatory redemption to the extent of Turbo Available Collections, as defined herein, pursuant to the Indenture ("**Turbo Redemptions**"). Turbo Redemptions, if any, of the Series 2017B Subordinate Bonds will be credited against the Series 2017B Subordinate Bonds in chronological order of scheduled maturity. As a result, payment of the principal of the Series 2017B Subordinate Bonds may be substantially earlier than their scheduled maturity dates. Failure to make Turbo Redemptions with respect to any Series 2017B Subordinate Bonds will not constitute an event of default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections.

See the inside cover for Maturity Dates, Interest Rates and Prices or Yields.

The Series 2017 Bonds are not debt of the State or the City, and neither the State nor the City is liable thereon. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, the revenues nor the taxing power of the State or the City is, or shall be deemed to be, pledged to the payment of any of the Series 2017 Bonds. TSASC has no taxing power.

Citigroup **Jefferies** **Siebert Cisneros Shank & Co., L.L.C.**

BofA Merrill Lynch **Barclays** **Loop Capital Markets**
Ramirez & Co., Inc. **Raymond James** **RBC Capital Markets**
Wells Fargo Securities

Academy Securities Inc. **Blaylock Beal Van, LLC** **BNY Mellon Capital Markets, LLC**
Cabrera Capital Markets, LLC **Drexel Hamilton, LLC** **FTN Financial Capital Markets**
Hilltop Securities Inc. **Janney Montgomery Scott** **Mesirow Financial, Inc.**
Mischler Financial Group, Inc. **Morgan Stanley** **Oppenheimer & Co.**
PNC Capital Markets LLC **Rice Financial Products Company** **Roosevelt & Cross Incorporated**
Stern Brothers & Co. **Stifel, Nicolaus & Company, Incorporated** **TD Securities**
U.S. Bancorp Investments, Inc. **The Williams Capital Group, L.P.**

The Series 2017 Bonds are offered when, as and if issued by TSASC and accepted by the Underwriters, subject to the approval of legality by Orrick, Herrington & Sutcliffe, LLP, New York, New York, as Transaction Counsel. Certain legal matters with respect to TSASC will be passed upon by Orrick, Herrington & Sutcliffe, LLP, as Transaction Counsel. Certain legal matters with respect to the City will be passed upon by its Corporation Counsel. Certain legal matters will be passed upon for the Underwriters by Hawkins Delafield & Wood LLP, New York, New York, and Hardwick Law Firm LLC, New York, New York, as Co-Underwriters' Counsel. It is expected that the Series 2017 Bonds will be available for delivery in book-entry form only through The Depository Trust Company in New York, New York, on or about November , 2016.

November , 2016

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* Preliminary, subject to change.

MATURITY SCHEDULE*

$1,024,385,000
TSASC, INC.
Tobacco Settlement Bonds

$584,385,000 Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior)

$457,685,000 Fiscal 2017 Series A Serial Bonds

Maturity (June 1)	Principal Amount	Interest Rate†	Price or Yield	CUSIP†† No. (Base CUSIP 898526)	Maturity (June 1)	Principal Amount	Interest Rate†	Price or Yield	CUSIP†† No. (Base CUSIP 898526)
2017	$10,510,000	%	%		2027	$26,585,000	%	%	
2018	12,625,000				2028	26,830,000			
2019	12,655,000				2029	27,275,000			
2020	18,375,000				2030	28,460,000			
2021	19,370,000				2031	28,030,000			
2022	20,375,000				2032	27,745,000			
2023	21,435,000				2033	26,790,000			
2024	22,550,000				2034	26,760,000			
2025	23,785,000				2035	26,165,000			
2026	25,135,000				2036	26,230,000			

$126,700,000 %† Fiscal 2017 Series A Term Bonds Due June 1, 2041, CUSIP†† No.

$440,000,000 Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate)

Fiscal 2017 Series B Turbo Term Bonds

$95,000,000 %† Fiscal 2017 Series B Turbo Term Bonds Due June 1, 2042 (Expected Average Life††† 3.45 yrs.) CUSIP†† No.

$135,000,000 %† Fiscal 2017 Series B Turbo Term Bonds Due June 1, 2045 (Expected Average Life††† 8.52 yrs.) CUSIP†† No.

$210,000,000 %† Fiscal 2017 Series B Turbo Term Bonds Due June 1, 2052 (Expected Average Life††† 14.00 yrs.) CUSIP†† No.

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* Preliminary, subject to change.

† Interest on the Series 2017 Bonds will be payable semi-annually on June 1 and December 1 of each year, commencing June 1, 2017.

†† Copyright, American Bankers Association ("ABA"). CUSIP data herein are provided by CUSIP Global Services, operated on behalf of the ABA by S&P Global Market Intelligence, a division of S&P Global Inc. The CUSIP numbers listed above are being provided solely for the convenience of holders of the Series 2017 Bonds only at the time of issuance of the Series 2017 Bonds and neither TSASC nor the Underwriters make any representation with respect to such numbers or undertakes any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2017 Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2017 Bonds.

††† Assumes all Turbo Redemptions are made based on the receipt of Turbo Available Collections (as defined herein) in accordance with the IHS Global Consumption Report and IHS Global Tribal Sales Report (each as defined herein), and other structuring assumptions. No assurance can be given that these assumptions will be realized. The timing and amounts of projected Turbo Redemptions for the Series 2017B Subordinate Bonds have not been separately rated. See "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

Certain capitalized terms used but not defined in the following paragraphs are defined in the Offering Circular on the pages noted in the Index of Defined Terms.

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 TSASC, the City 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 is currently a limited secondary market for securities such as the Series 2017 Bonds. There can be no assurance that a secondary market for the Series 2017 Bonds will develop, or if one develops, that it will provide bondholders with liquidity or that it will continue for the life of the Series 2017 Bonds.

This Offering Circular has been prepared by TSASC and contains information furnished by TSASC, IHS Global and other sources, all of which are believed to be reliable. The information contained under the caption "IHS GLOBAL CONSUMPTION REPORT" and "IHS GLOBAL TRIBAL SALES REPORT" and in APPENDIX A—"IHS GLOBAL REPORTS" has been included in reliance upon IHS Global as an expert in econometric forecasting. Information concerning the domestic tobacco industry and participants therein has been obtained from certain publicly available information provided by certain participants and certain other sources (see "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY"). The participants in such industry have not provided any information to TSASC for use in connection with this offering. In certain cases, domestic tobacco industry information provided herein (such as market share data) may be derived from sources which are inconsistent or conflict with each other. TSASC does not have any independent knowledge of any facts indicating that the information contained herein under the heading "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" is inaccurate in any material respect, but TSASC has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information.

Marks Paneth LLP, TSASC's independent auditor, has not reviewed, commented on or approved, and is not associated with, this Offering Circular. The report of Marks Paneth LLP relating to TSASC's financial statements for the Fiscal Years ended June 30, 2016 and 2015, which is a matter of public record, is included in this Offering Circular. See APPENDIX E. However, Marks Paneth LLP has not performed any procedures on any financial statements or other financial information of TSASC, including without limitation any of the information contained in this Offering Circular, since the date of such report and has not been asked to consent to the inclusion of its report in this Offering Circular.

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 TSASC or the matters covered by the reports of IHS Global included as APPENDIX A to this Offering Circular or the matters described relating to the domestic tobacco industry herein under the heading "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" since the date hereof or that the information contained herein is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party. See "CONTINUING DISCLOSURE UNDERTAKING".

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Pledged TSRs (see "RISK FACTORS", "LEGAL CONSIDERATIONS", "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT",

"IHS GLOBAL CONSUMPTION REPORT" and "IHS GLOBAL TRIBAL SALES REPORT"), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by TSASC, its independent auditors, its financial advisors, the City, IHS Global or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

References in this Offering Circular to the Indenture and the TSR Purchase Agreement (each as defined herein) do not purport to be complete. Refer to the Indenture and the TSR Purchase Agreement for full and complete details of their provisions. Copies of the Indenture and the TSR Purchase Agreement are on file with the Indenture Trustee.

If and when included in this Offering Circular, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," "structured," "targets," 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 TSASC. These forward-looking statements speak only as of the date of this Offering Circular. TSASC and the Underwriters disclaim any obligation or undertaking to release any updates or revisions to any forward-looking statement contained herein to reflect any changes in TSASC's expectations with regard thereto or any change in events, conditions, or circumstances on which any such statement is based.

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

THE PROPOSED SECURITIES TRANSACTIONS DESCRIBED HEREIN WILL BE MADE ON THE BASIS OF EXEMPTIONS FROM REGISTRATION PROVIDED IN THE SECURITIES ACT OF 1933, AS AMENDED.

THE SERIES 2017 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS 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.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Offering Circular and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2017 Bonds to potential investors is made only by means of the entire Offering Circular. 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 between or among any of TSASC, the City and the Bondholders. Capitalized terms used in this Offering Circular and not otherwise defined shall have the meanings given such terms in the Indenture and the TSR Purchase Agreement. See APPENDIX I — "DEFINITIONS AND SUMMARY OF THE INDENTURE". For locations of definitions of certain terms used herein, see "Index of Defined Terms" at the end of this Offering Circular.

Overview..... TSASC, Inc. ("**TSASC**") is issuing $584,385,000* aggregate principal amount of its Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior) (the "**Series 2017A Senior Bonds**") and $440,000,000* aggregate principal amount of its Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate) (the "**Series 2017B Subordinate Bonds**" and, together with the Series 2017A Senior Bonds, the "**Series 2017 Bonds**") for the purpose of refunding all of its outstanding indebtedness. See "PLAN OF FINANCE." The Series 2017 Bonds are being issued pursuant to the Indenture hereinafter referred to. The Series 2017A Senior Bonds will be senior to the Series 2017B Subordinate Bonds in payment priority under the Indenture, as described herein. In addition to the Series 2017 Bonds, the Indenture permits the issuance of Additional Bonds, subject to the satisfaction of certain conditions set forth in the Indenture, and also permits the issuance of Junior Bonds, as defined and described herein. See "THE SERIES 2017 BONDS—Additional Bonds" herein. The Series 2017 Bonds, together with any Additional Bonds and Junior Bonds issued under the Indenture, are referred to herein as the "**Bonds**."

TSASC has, pursuant to the TSR Purchase Agreement hereinafter referred to, purchased the "**Tobacco Assets**", which are all of the right, title and interest of The City of New York (the "**City**") under the Master Settlement Agreement described herein (the "**MSA**") and the Consent Decree and Final Judgment related thereto, including the City's right to receive its portion of the Annual Payments (as hereinafter defined) payable under the MSA (the "**Tobacco Settlement Revenues**" or "**TSRs**"). The Series 2017 Bonds are secured by and are payable solely from the Pledged TSRs (as hereinafter defined) and the other collateral pledged under the Indenture, all as more fully described herein. The "**Pledged TSRs**" are the right, title and interest of TSASC in and to 37.40% of the Tobacco Assets.

The right of the Indenture Trustee (as hereinafter defined) to receive Pledged TSRs is equal to and on a parity with, and is not inferior or superior to, the right of TSASC to receive the portion of the TSRs that have not been pledged under the Indenture (the "**Unpledged TSRs**"). The Indenture Trustee shall have no right to any Unpledged TSRs under any circumstance, including a deficiency in the Pledged TSRs.

The Bonds do not constitute debt of the State of New York (the "**State**") or the City, and neither the State nor the City is liable thereon. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, the revenues nor the taxing power of the State or the City is pledged to the payment of any of the Bonds. TSASC has no taxing power.

* Preliminary, subject to change.

TSASC..... TSASC is a special purpose, bankruptcy-remote local development corporation incorporated under the provisions of Section 1411 of the New York Not-For-Profit Corporation Law. TSASC is an instrumentality of, but separate and apart from, the City.

Master Settlement Agreement..... On November 23, 1998, the MSA was entered into by 46 states (including the State), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and what were then the four largest United States tobacco manufacturers: Philip Morris USA Inc. ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**"). In January 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. On June 12, 2015, Reynolds American acquired Lorillard, Inc., of which Lorillard was a wholly-owned subsidiary, and Lorillard was merged into Reynolds Tobacco, with Reynolds Tobacco as the surviving entity. Contemporaneous with Reynolds American's acquisition of Lorillard, Inc., Imperial Tobacco Group PLC ("**Imperial Tobacco**") purchased certain of Reynolds Tobacco's and certain of Lorillard, Inc.'s cigarettes brands, among other assets. The payment obligations under the MSA follow tobacco product brands if they are transferred; thus, Imperial Tobacco is required to make payments under the MSA as a result of its acquisition of those cigarette brands.

On October 21, 2016, British American Tobacco p.l.c. ("**BAT**") announced its offer to acquire all Reynolds American stock not currently owned by BAT. BAT currently owns approximately 42% of Reynolds American shares, and its acquisition proposal entails the purchase of all other Reynolds American shares for approximately $47 billion in a combined cash and stock transaction. As noted above, the payment obligations under the MSA follow tobacco product brands if they are transferred; thus, if the acquisition is approved and consummated and if BAT is the surviving entity, BAT will be required to make payments under the MSA attributable to the acquired Reynolds American cigarette brands.

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

The MSA is an industry-wide settlement of litigation between the OPMs and SPMs (collectively, the "**Participating Manufacturers**" or "**PMs**") and the Settling States, and resolved cigarette smoking-related litigation among the Settling States and the OPMs, released the PMs from past and present smoking-related claims by the Settling States and provides for a continuing release of future smoking-related claims in exchange for certain payments to be made to the Settling States. The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things. TSASC is not a party to the MSA. "See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

MSA Payments..... Under the MSA, the OPMs are required to pay to the Settling States the Tobacco Settlement Revenues consisting of (i) five initial payments (the "**Initial Payments**") (all of which have been previously made by the OPMs), (ii) annual payments (the "**Annual Payments**"), which are required to be made annually on each April 15, having commenced April 15, 2000, and continuing in perpetuity, and (iii) certain other payments known as Strategic Contribution Payments ("**Strategic Contribution Payments**"). The City (and therefore TSASC) does not have any interest in the Strategic Contribution Payments and, consequently, they are not discussed herein. SPMs are also required to make Annual Payments in certain circumstances. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Subsequent Participating Manufacturers."

The Annual Payments due under the MSA are subject to numerous adjustments, some of which are material. Such adjustments include reductions when the PMs experience a loss of market share to tobacco companies that do not become part of the MSA ("**Non-Participating Manufacturers**" or "**NPMs**"), as a result of the PMs' participation in the MSA (the "**NPM Adjustment**"). The NPM Adjustment has been the subject of disputes between the State and PMs, as well as other Settling States and the PMs, since at least 2004. The dispute between the PMs and the State has been addressed in a settlement agreement which became effective October 16, 2015 (the "**NY NPM Settlement**"). For a discussion of the NY NPM Settlement and its potential impact on amounts due to the State under the MSA, see "NY NPM SETTLEMENT" and "IHS GLOBAL TRIBAL SALES REPORT". A copy of the NY NPM Settlement is included in APPENDIX D.

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

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

Payments by the PMs are required to be made to Citibank, N.A., as the MSA Escrow Agent appointed pursuant to the MSA (the "**MSA Escrow Agent**"), which is required, in turn, to remit an allocable share of such payments to the parties entitled thereto. The MSA Escrow Agent has distributed the Annual Payments due through April 15, 2016 to the Settling States. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT."

NY NPM Settlement..... Under the NY NPM Settlement, the State will no longer be subject to NPM Adjustments provided for in the MSA, except in limited circumstances. The NY NPM Settlement resolves NPM Adjustment disputes between the State and the PMs relating to calendar years 2004 through 2014. For 2015 and later years, the NY NPM Settlement establishes sets of circumstances under which the PMs shall be entitled to credits against future payments to the State, one of which, the Tribal NPM Packs credit, is expected to materially affect payments to the State under the MSA. The Tribal NPM Packs credit is based on the number of packs of NPM cigarettes (including NPM packs manufactured on reservations) sold to non-Native American State consumers on or from Native American reservations in the State, on which packs the State cigarette

excise tax is not paid. See "NY NPM SETTLEMENT" and "IHS GLOBAL TRIBAL SALES REPORT."

New York Consent Decree..... According to the formula set forth in the MSA, the State is entitled to 12.7620310% of the total amount of Annual Payments deposited in the national escrow account. The Consent Decree and Final Judgment (the "**Decree**"), which was entered into by the Supreme Court of the State of New York in December 1998, allocates this share of the Annual Payments among the State (51.176%), the City (26.670%) and the other counties within the State (22.154%). The Decree became final on August 17, 1999 and is not subject to further appeal. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "NEW YORK CONSENT DECREE".

Sale of Tobacco Settlement Revenues..... Pursuant to a Purchase and Sale Agreement dated as of November 18, 1999, as amended (the "**TSR Purchase Agreement**"), the City sold to TSASC the Tobacco Assets, including the City's right to receive its portion of the TSRs. As a result, TSASC is entitled to receive 3.4036337% of all Annual Payments made by the PMs under the MSA. Under the Indenture, however, TSASC has assigned and pledged only 37.40% of the Tobacco Assets, constituting the Pledged TSRs, to the Indenture Trustee as security for the Bonds. See "—Collateral for the Bonds" below. The State and the City have issued irrevocable instructions informing the MSA Escrow Agent that payments of TSRs owed to the City have been sold to TSASC and directing the MSA Escrow Agent to disburse the TSRs directly to the Indenture Trustee. Accordingly, the moneys to which TSASC is entitled are not to pass through the State or the City and are not to be subject to State or City appropriation.

The purchase price paid by TSASC to the City under the TSR Purchase Agreement consisted of: (i) the net proceeds of the sale of TSASC's first issuance of bonds in 1999 and (ii) TSASC's 100% beneficial ownership interest in the TSASC Tobacco Settlement Trust (the "**Trust**"). The assets of the Trust consist primarily of a security (the "**Residual Certificate**") which currently entitles the Trust to the net proceeds of TSASC's Bonds issued under the Indenture after its first issuance of bonds in 1999 (other than Refunding Bonds), and to the Unpledged TSRs received by TSASC. The City owns the sole beneficial interest in the Trust.

Industry Overview ..... Philip Morris and Reynolds Tobacco (both OPMs) are the largest manufacturers of cigarettes in the United States (based on 2015 market share). As noted above, on October 21, 2016, BAT announced its offer to acquire all Reynolds American stock not currently owned by BAT. The market for cigarettes is highly competitive and is characterized by brand recognition. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY."

As reported by the National Association of Attorneys General ("**NAAG**"), based upon OPM shipments reported to Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data ("**MSAI**"), the OPMs accounted for approximately 84.54%[(*)] of the U.S. domestic cigarette market in payment year 2016 (sales year 2015), based upon shipments and measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

(*) OPMs make payments under the MSA based upon the 0.0325 ounce per cigarette conversion rate, and SPMs make payments under the MSA based upon the 0.09 ounce per cigarette conversion rate. The aggregate market share information is based on information as reported by NAAG and may differ materially from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY." The aggregate market share information for sales year 2015 from NAAG used in the Pledged TSRs Projection Methodology and Assumptions may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to Annual Payments in future years. See "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments."

Also as reported by NAAG, based upon shipments reported to MSAI, the SPMs accounted for approximately 8.60%[*] of the U.S. domestic cigarette market in payment year 2016 (sales year 2015), based upon shipments and measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate.

Cigarette Consumption..... As described in the IHS Global Consumption Report (as defined below), domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980s, 1990s and 2000s, falling to less than 400 billion cigarettes in 2003 and 264 billion cigarettes in 2014, before increasing slightly to 269 billion cigarettes in 2015. The IHS Global Consumption Report projects that consumption declines will resume in 2016 and thereafter. See "IHS GLOBAL CONSUMPTION REPORT" and APPENDIX A-1—"IHS GLOBAL CONSUMPTION REPORT".

Tribal NPM Packs Volume ..... Under the NY NPM Settlement, in-State calendar year sales of Tribal NPM Packs (as defined herein) to State consumers generate a credit to the PMs reducing their obligations to pay TSRs to the State for that year. The size of the credit per Tribal NPM Pack varies depending on the annual quantity of Tribal NPM Packs determined to have been sold in the year in question. See "NY NPM SETTLEMENT—Credit to Settlement Agreement PMs for Sales in the State of Certain NPM Cigarettes—*Tribal NPM Packs Credit*" and APPENDIX A-2—"IHS GLOBAL TRIBAL SALES REPORT."

IHS Global Consumption Report..... IHS Global Inc. ("**IHS Global**") has prepared a report dated November 7, 2016 on the consumption of cigarettes in the United States from 2016 through 2052 entitled, "A Forecast of U.S. Cigarette Consumption (2016-2052) for TSASC, Inc." (the "**IHS Global Consumption Report**").

IHS Global's cigarette consumption model is based on historical United States data between 1965 and 2015. In the IHS Global Consumption Report, IHS Global has projected the average annual rate of decline in U.S. cigarette consumption from 2016 through 2052 to be 3.0%, resulting in a forecast of total U.S. cigarette consumption in 2052 to be 88.2 billion cigarettes (a 67% decline from the 2015 level). The projections and forecasts regarding future cigarette consumption included in the IHS Global Consumption Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts. See "IHS GLOBAL CONSUMPTION REPORT" and APPENDIX A-1—"IHS GLOBAL CONSUMPTION REPORT". See also "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

IHS Global Tribal Sales Report..... IHS Global has prepared a report dated as of November 7, 2016 on projected volume of untaxed NPM cigarettes sold to non-tribal consumers by on-reservation cigarette retailers in the State from 2015 through 2052 entitled "Cigarette Purchases by New York Consumers from Tribal Retailers in New York State" (the "**IHS Global Tribal Sales Report**"). Under the NY NPM Settlement, Tribal NPM Packs sales will result in

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[*] OPMs make payments under the MSA based upon the 0.0325 ounce per cigarette conversion rate, and SPMs make payments under the MSA based upon the 0.09 ounce per cigarette conversion rate. The aggregate market share information is based on information as reported by NAAG and may differ materially from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY." The aggregate market share information for sales year 2015 from NAAG used in the Pledged TSRs Projection Methodology and Assumptions may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to Annual Payments in future years. See "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments."

reductions of TSRs paid by the PMs to the State beginning in 2017. The IHS Global Tribal Sales Report estimates Tribal NPM Packs sales of 54.2 million packs in 2015 and 49.8 million packs in 2016 and forecasts that Tribal NPM Packs sales will fall by 75% to 13.5 million packs by 2052. See APPENDIX A-2—"IHS GLOBAL TRIBAL SALES REPORT".

Pledged TSRs Projection Methodology and Bond Structuring Assumptions..... Certain assumptions, forecasts and methodology were used to calculate a forecast of Pledged TSRs to be received by TSASC (including forecasts of United States cigarette consumption based on the IHS Global Consumption Report and a forecast of Tribal NPM Packs sales based on the IHS Global Tribal Sales Report, both reports also being based on assumptions) and the anticipated application of certain adjustments and offsets to Annual Payments to be made by the PMs pursuant to the MSA. Once Pledged TSRs were forecast, certain structuring assumptions for the Series 2017 Bonds were applied. In addition, such forecasts were used to project amounts expected to be available for redemption of the Series 2017B Subordinate Bonds from Turbo Redemptions (described below) and the resulting expected average lives of the Series 2017B Subordinate Bonds. No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviation from such assumptions and forecasts could materially and adversely affect the payment of the Series 2017 Bonds. See "TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE," "SERIES 2017B SUBORDINATE BONDS PROJECTED TURBO REDEMPTIONS UNDER VARIOUS CONSUMPTION DECLINE SCENARIOS AND VARIOUS TRIBAL NPM PACK SALES SCENARIOS," "BREAKEVEN CONSUMPTION AND REVENUE DECLINE RATES BY MATURITY" and "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Collateral for the Bonds ..... The Bonds are limited obligations of TSASC payable solely from and secured solely by (a) the Pledged TSRs and TSASC's right to enforce certain covenants made by the City in the TSR Purchase Agreement; (b) the Collections Account (except to the extent that money therein is allocable to the Unpledged TSRs Subaccount, the Operating Account or the Rebate Account), the Debt Service Accounts, the Liquidity Reserve Accounts, the Lump Sum Redemption Account, the Turbo Redemption Account, and all subaccounts contained in such accounts other than the Unpledged TSRs Subaccount in the Collections Account (collectively, the "**Pledged Accounts**"), all money, instruments, general intangibles, investment property, or other property credited to or on deposit in the Pledged Accounts (which excludes money in the Collections Account allocable to the Unpledged TSRs Subaccount, the Operating Account or the Rebate Account) and all investment earnings on amounts on deposit in or credited to the Pledged Accounts; and (c) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of the foregoing (collectively, the "**Collateral**").

The Pledged TSRs represent the right, title and interest of TSASC in and to 37.40% of the Tobacco Assets.

Securities Offered..... The Series 2017 Bonds will be issued pursuant to an Amended and Restated Indenture, dated as of November 1, 2016 (the "**Indenture**"), between TSASC and The Bank of New York Mellon, as trustee (the "**Indenture Trustee**"), and a series supplement thereto, to be entered into between TSASC and the Indenture Trustee in connection with the issuance of the Series 2017 Bonds.

It is expected that the Series 2017 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about November __, 2016 (the "**Closing Date**"). The Series 2017 Bonds other than the Series 2017B Subordinate Bonds maturing on June 1, 2052* will be available for purchase in denominations of $5,000 or any integral multiple thereof. The Series 2017B Subordinate Bonds maturing on June 1, 2052* will be available for purchase in denominations of $100,000 and integral multiples of $5,000 in excess thereof. Beneficial owners of the Series 2017 Bonds will not receive physical delivery of bond certificates.

The Series 2017A Senior Bonds will be senior to the Series 2017B Subordinate Bonds in payment priority under the Indenture, as described below.

The Series 2017B Subordinate Bonds are expected to be issued as Turbo Term Bonds and are subject to Turbo Redemptions as described below.

Interest..... Interest on the outstanding principal amount of the Series 2017 Bonds will be payable on each June 1 and December 1, commencing June 1, 2017 (each, a "**Distribution Date**"). Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Senior Liquidity Reserve Account, described below, is available to pay interest on the Series 2017A Senior Bonds when due, and the Subordinate Liquidity Reserve Account, described below, is available to pay interest on the Series 2017B Subordinate Bonds when due. Failure to pay the full amount of interest on the Series 2017 Bonds when due is an Event of Default under the Indenture; however, a payment default with respect to the Series 2017A Senior Bonds will not result in acceleration of any of the Series 2017 Bonds, and a payment default with respect to the Series 2017B Subordinate Bonds will not result in acceleration of the Series 2017A Senior Bonds, as described further herein. See "SECURITY FOR THE BONDS—Application of Collections" and "—Events of Default and Remedies".

Principal..... Principal is payable on the Series 2017 Bonds on their respective scheduled Maturity Dates as set forth on the inside cover. Principal is also due on the Series 2017A Senior Bonds that are Term Bonds on the Mandatory Sinking Fund Installment payment dates, as described below. Principal is also payable on the Series 2017B Subordinate Bonds by Turbo Redemptions, to the extent of Turbo Available Collections, as described below. So long as no Event of Default has occurred, all payments of principal made on the Series 2017B Subordinate Bonds from Collections will be credited against respective scheduled Maturity Dates in chronological order as more fully described herein. See "THE SERIES 2017 BONDS".

The Senior Liquidity Reserve Account, described below, is available to pay the principal of Series 2017A Senior Bonds on their respective scheduled Maturity Dates and Mandatory Sinking Fund Installment payment dates, and the Subordinate Liquidity Reserve Account, described below, is available to pay the principal of Series 2017B Subordinate Bonds on their respective scheduled Maturity Dates. The Liquidity Reserve Accounts will not be available to make Turbo Redemptions of the Series 2017B Subordinate Bonds. Failure to pay the principal of a Series 2017 Bond on its scheduled Maturity Date or Mandatory Sinking Fund Installment payment date will constitute an Event of Default under the Indenture, in which case all future payments will be made as described herein; however, a payment default with respect to the Series 2017A Senior Bonds will not result in acceleration of any of the Series 2017 Bonds, and a payment default with respect to the Series 2017B Subordinate Bonds will not result in acceleration of the Series 2017A Senior Bonds, as described further herein. Failure to make Turbo Redemptions with respect to any Series 2017B Subordinate

* Preliminary, subject to change.

Bonds will not constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections. See "SECURITY FOR THE BONDS—Application of Collections" and "—Events of Default and Remedies".

Redemption Provisions:[*]

Optional Redemption..... *Optional Redemption of Series 2017A Senior Bonds.* The Series 2017A Senior Bonds are subject to optional redemption (from any source other than moneys in the Pledged Accounts) at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date, in whole or in part, in applicable authorized denominations, on any date on or after June 1, ____, from any maturity selected by TSASC in its discretion and on such basis as the Indenture Trustee shall deem fair and appropriate, including by lot, within a maturity.

Optional Redemption of Series 2017B Subordinate Bonds. The Series 2017B Subordinate Bonds are subject to optional redemption (from any source other than moneys in the Pledged Accounts), at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date: (1) in whole or in part, in applicable authorized denominations, at any time, but only in an amount that may not exceed the cumulative amount of the Turbo Redemptions that were projected (using the forecast contained in the IHS Global Consumption Report and the base case forecast contained in the IHS Global Tribal Sales Report) to be paid, as set forth in "TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE—Projected Series 2017 Debt Service Schedule Incorporating Turbo Redemptions of the Series 2017B Subordinate Bonds", but, as of the date of such redemption, have not been paid with respect to each Series 2017B Subordinate Bond, and (2) in whole or in part, in applicable authorized denominations, on any date on or after June 1, ____, from any maturity selected by TSASC in its discretion and on such basis as the Indenture Trustee shall deem fair and appropriate, including by lot, within a maturity.

Mandatory Redemption of Series 2017A Senior Bonds from Mandatory Sinking Fund Installments..... The Series 2017A Senior Bonds maturing on June 1, 2041 are Term Bonds subject to mandatory redemption from scheduled principal payments ("**Mandatory Sinking Fund Installments**") as set forth in "THE SERIES 2017 BONDS — Redemption Provisions — Mandatory Redemption of Series 2017A Senior Bonds from Mandatory Sinking Fund Installments".

Turbo Redemptions of the Series 2017B Subordinate Bonds..... The Indenture requires that all Collections (as defined herein) that are in excess of the amounts required for the funding of Operating Expenses, interest and principal due, and deficiencies in the Liquidity Reserve Accounts, if any (such excess, "**Turbo Available Collections**"), as described in "SECURITY FOR THE BONDS—Application of Collections," be applied to the redemption, in applicable authorized denominations, of the Series 2017B Subordinate Bonds on each Distribution Date as described herein (each such payment, a "**Turbo Redemption**"). Such Turbo Available Collections will be deposited in an account established and maintained by the Indenture Trustee under the Indenture (the "**Turbo Redemption Account**"). Turbo Redemptions are not scheduled amortization payments, and are required to be made only from Turbo Available Collections, if any. Amounts in the Liquidity Reserve Accounts are not available to make Turbo Redemptions. See "THE SERIES 2017 BONDS —

[*] Preliminary, subject to change.

Redemption Provisions — Turbo Redemptions of the Series 2017B Subordinate Bonds" herein.

Mandatory Redemption from Lump Sum Payments and Total Lump Sum Payments..... The Series 2017 Bonds shall be redeemed in whole or in part prior to their stated maturity dates at the principal amount thereof being redeemed, without premium, (i) on any Distribution Date from Lump Sum Payments (as defined herein) on deposit in the Lump Sum Redemption Account and (ii) on the earliest practicable Business Day from Total Lump Sum Payments (as defined herein) on deposit in the Lump Sum Redemption Account.

Clean-Up Calls ..... *Optional Clean-Up Call of Senior Bonds*. The Series 2017A Senior Bonds and any Additional Bonds secured on parity with the Series 2017A Senior Bonds (collectively, the "**Senior Bonds**") are subject to optional redemption in whole, at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed plus interest accrued to the redemption date at any time that the available amounts on deposit in the Pledged Accounts allocable to the Senior Bonds exceed the aggregate principal amount of, and accrued interest on, all Outstanding Senior Bonds.

Mandatory Clean-Up Call of Subordinate Bonds. The Series 2017B Subordinate Bonds and any Additional Bonds secured on parity with the Series 2017B Subordinate Bonds (collectively, the "**Subordinate Bonds**") are subject to mandatory redemption in whole, at a redemption price equal to 100% of the principal amount being redeemed plus interest accrued to the redemption date at any time that the available amounts on deposit in the Pledged Accounts allocable to the Subordinate Bonds exceed the aggregate principal amount of, and accrued interest on, all Outstanding Subordinate Bonds.

Limitation on Open Market Purchases ..... Moneys in the Pledged Accounts will not be used to make open market purchases of the Series 2017B Subordinate Bonds.

Moneys in the Surplus Account may be used to make open market purchases of the Series 2017A Senior Bonds at a price no greater than 100% of the principal amount thereof plus interest accrued to the date of settlement. Any Series 2017A Senior Bonds so purchased shall be delivered to the Indenture Trustee for cancellation.

Liquidity Reserve Accounts..... A reserve account (the "**Senior Liquidity Reserve Account**") will be established and maintained by the Indenture Trustee under the Indenture and funded on the Closing Date in an amount equal to $45,939,652.78* (the "**Senior Liquidity Reserve Requirement**"), as security for the Senior Bonds. A reserve account (the "**Subordinate Liquidity Reserve Account**" and, together with the Senior Liquidity Reserve Account, the "**Liquidity Reserve Accounts**") will be established and maintained by the Indenture Trustee under the Indenture and funded on the Closing Date in an amount equal to $20,546,666.67* (the "**Subordinate Liquidity Reserve Requirement**" and, together with the Senior Liquidity Reserve Requirement, the "**Liquidity Reserve Requirements**"), as security for the Subordinate Bonds. TSASC is required to maintain the applicable Liquidity Reserve Requirement in the applicable Liquidity Reserve Account, to the extent of funds available for such purpose pursuant to the Indenture.

Amounts on deposit in the Senior Liquidity Reserve Account will be available to pay interest on the Series 2017A Senior Bonds, principal on the respective scheduled Maturity Dates and Mandatory Sinking Fund Installments of the Series 2017A Senior

* Preliminary, subject to change.

Bonds, to the extent available Collections are insufficient for such purpose. Amounts on deposit in the Subordinate Liquidity Reserve Account will be available to pay interest on the Series 2017B Subordinate Bonds and principal on the respective scheduled Maturity Dates of the Series 2017B Subordinate Bonds, to the extent available Collections are insufficient for such purpose. Amounts in the Liquidity Reserve Accounts will not be available to make Turbo Redemptions of the Series 2017B Subordinate Bonds. Any amounts remaining in the respective Liquidity Reserve Account in excess of the respective Liquidity Reserve Requirement will be deposited in the corresponding Debt Service Account.

Distributions and Priorities.... The Indenture Trustee shall deposit all Collections (as defined herein) in the Collections Account promptly upon receipt. All Collections that have been identified by an Officer's Certificate as consisting of Lump Sum Payments or Total Lump Sum Payments (each as defined herein) received by the Indenture Trustee shall be promptly (and, in any event, no later than the Business Day immediately preceding the next following Distribution Date) transferred to the Lump Sum Redemption Account and applied as described in "SECURITY FOR THE BONDS—Application of Collections—Lump Sum Payments and Total Lump Sum Payments." Amounts constituting Unpledged TSRs will initially be deposited in the Collections Account, and, as confirmed in writing to the Indenture Trustee in an Officer's Certificate, the Indenture Trustee shall promptly deposit such Unpledged TSRs to the Unpledged TSRs Subaccount and then promptly remit such amount to the registered owner of the Residual Certificate.

At any time after making all transfers described above but no later than five Business Days prior to each Distribution Date, the Indenture Trustee shall withdraw Collections on deposit in the Collections Account, including any investment earnings thereon, and transfer to the Operating Account the amounts specified by an Officer's Certificate delivered in order to pay (x) the Operating Expenses in the then current Fiscal Year to the extent that the amount thereof does not exceed, together with amounts previously drawn from the Collections Account for such purpose, the Operating Cap for the then current Fiscal Year, (y) the Operating Expenses for the next succeeding Fiscal Year to the extent that the amount thereof does not exceed the Operating Cap for such Fiscal Year and (z) the Tax Obligations.

Transfers to Accounts. No later than three Business Days prior to each Distribution Date, the Indenture Trustee shall apply amounts in the various Accounts as follows:

(i) from the Senior Liquidity Reserve Account to the Collections Account, any amount in excess of the Senior Liquidity Reserve Requirement pursuant to the Indenture; and

(ii) unless a Subordinate Payment Default (as defined below) has occurred, from the Subordinate Liquidity Reserve Account to the Subordinate Debt Service Account, any amount in excess of the Subordinate Liquidity Reserve Requirement pursuant to the Indenture.

After making the transfers described above and no later than two Business Days prior to each Distribution Date, the Indenture Trustee shall withdraw the Collections on deposit in the Collections Account, including any investment earnings thereon, and transfer such amounts as follows:

(i) to the Senior Debt Service Account, an amount sufficient to cause the amount therein to equal unpaid interest due on the Outstanding Senior Bonds on the next Distribution Date;

(ii) to the Senior Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (i) above), to

equal the principal of Outstanding Senior Bonds due on or prior to the next Distribution Date;

(iii) to the Senior Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clauses (i) and (ii) above), together with any additional amounts in excess of the Senior Liquidity Reserve Requirement required to be transferred or anticipated to be transferred (as determined by an Officer's Certificate) from the Senior Liquidity Reserve Account to the Collections Account as described above, to equal interest due on Outstanding Senior Bonds on the second succeeding Distribution Date;

(iv) to the Senior Liquidity Reserve Account, an amount sufficient to cause the amount therein to equal the Senior Liquidity Reserve Requirement;

(v) if a Subordinate Payment Default has occurred, to the Subordinate Extraordinary Payment Account all amounts remaining in the Collections Account up to the amount required to fully retire all of the Outstanding Subordinate Bonds, including all interest and principal thereon;

(vi) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein to equal interest due on Outstanding Subordinate Bonds on the next Distribution Date;

(vii) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (vi) above), to equal the principal of Outstanding Subordinate Bonds due on or prior to the next Distribution Date;

(viii) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clauses (vi) and (vii) above), together with any additional amounts in excess of the Subordinate Liquidity Reserve Requirement required to be transferred or anticipated to be transferred (as determined by an Officer's Certificate) from the Subordinate Liquidity Reserve Account as described above, to equal interest due on Outstanding Subordinate Bonds on the second succeeding Distribution Date;

(ix) to the Subordinate Liquidity Reserve Account, an amount sufficient to cause the amount therein to equal the Subordinate Liquidity Reserve Requirement;

(x) 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 in order to pay, for the current or next succeeding Fiscal Year, Operating Expenses in excess of the Operating Cap up to a maximum of $150,000 for any Fiscal Year;

(xi) to the Turbo Redemption Account, all amounts remaining in the Collections Account up to the amount necessary to redeem all then Outstanding Subordinate Bonds; and

(xii) to the Surplus Account (which is not a Pledged Account), all amounts remaining in the Collections Account which may then be applied pursuant to an Officer's Certificate to redeem Senior Bonds or make open market purchases of Senior Bonds pursuant to the Indenture, to the extent that Senior Bonds are then Outstanding, or otherwise pursuant to the Residual Certificate.

Distribution Date Transfers. On each Distribution Date, the Indenture Trustee shall apply amounts in the various Accounts in the following order of priority:

(i) from the Senior Debt Service Account and the Senior Liquidity Reserve Account, in

that order, to pay interest on the Outstanding Senior Bonds due on such Distribution Date;

(ii) from the Senior Debt Service Account and the Senior Liquidity Reserve Account, in that order, to pay principal of Outstanding Senior Bonds due on or prior to such Distribution Date in chronological order of the date on which such principal is due and Pro Rata within such a principal due date;

(iii) if a Subordinate Payment Default has occurred, from the Subordinate Extraordinary Payment Account, the Subordinate Debt Service Account, the Turbo Redemption Account and the Subordinate Liquidity Reserve Account, if any, to pay Extraordinary Payments (as defined herein) pursuant to the Indenture;

(iv) from the Subordinate Debt Service Account and the Subordinate Liquidity Reserve Account, in that order, to pay interest on the Outstanding Subordinate Bonds due on such Distribution Date;

(v) from the Subordinate Debt Service Account and the Subordinate Liquidity Reserve Account, in that order, to pay principal of Outstanding Subordinate Bonds due on such Distribution Date in chronological order of the date on which such principal is due and Pro Rata within such a principal due date; and

(vi) from the Turbo Redemption Account, to make Turbo Redemption payments on Subordinate Turbo Term Bonds in accordance with the Indenture.

Upon the occurrence of any failure to pay when due any principal or interest on any Senior Bonds (a "**Senior Payment Default**"), all Pledged TSRs (after payment of Indenture Trustee fees and other Operating Expenses up to the Operating Cap) will be applied solely to funding the Senior Debt Service Account, and replenishing the Senior Liquidity Reserve Account, until all payments of interest on, Mandatory Sinking Fund Installments on, and maturing principal of the Senior Bonds are current and all such Accounts fully funded as described above, after which any remaining Pledged TSRs may be applied to payment of amounts due on any Outstanding Subordinate Bonds. A Senior Payment Default with respect to the Series 2017A Senior Bonds relating to non-payment of principal includes a failure to pay principal on any Mandatory Sinking Fund Installment payment date or on the Maturity Dates.

Upon the occurrence of any failure to pay when due any principal or interest on any Subordinate Bonds (a "**Subordinate Payment Default**") and continuing on each succeeding Distribution Date commencing with the Distribution Date following such Subordinate Payment Default, the Indenture Trustee shall apply all funds in the Subordinate Extraordinary Payment Account, the Subordinate Debt Service Account (if any), the Subordinate Liquidity Reserve Account (if any) and the Turbo Redemption Account (if any) to pay (or prepay) with respect to the Subordinate Bonds, Pro Rata, without regard to their order of maturity, in the following order: (i) past due interest on the Subordinate Bonds, (ii) accrued and unpaid interest on the Subordinate Bonds, and (iii) principal of the Subordinate Bonds without premium ("**Extraordinary Payments**"). Failure to make Turbo Redemptions with respect to Turbo Term Bonds (including the Series 2017B Subordinate Bonds) will not constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections.

See "SECURITY FOR THE BONDS—Application of Collections."

Events of Default..... The occurrence of any of the following events will constitute an "**Event of Default**" under the Indenture: (i) a Senior Payment Default; (ii) a Subordinate Payment Default; (iii) failure of TSASC to observe or perform any other covenant, condition, agreement, or provision contained in the Bonds or the Indenture (other than the covenant to comply

with the applicable continuing disclosure undertaking) which is not remedied within 60 days after Written Notice, specifying such default and requiring the same to be remedied, has been given to TSASC by the Indenture Trustee or by the Owners of at least 25% in principal amount of the Bonds then Outstanding; and (iv) the failure of the City to observe or perform its covenant made in the TSR Purchase Agreement and included in the Indenture that it will not limit or alter the rights of TSASC to fulfill the terms of its agreements with Owners of the Outstanding Bonds or in any way impair the rights and remedies of such Owners or the security for such Bonds which breach is not remedied within 60 days after Written Notice. If the default with respect to clause (iii) or (iv) above is such that it cannot be corrected within 60 days, it will not constitute an Event of Default if corrective action is instituted by TSASC or the City, as applicable, within 60 days and diligently pursued until the default is corrected.

Notwithstanding the foregoing, a Subordinate Payment Default (i) shall not cause any Senior Bonds to be deemed to be in default if the payment of all interest and principal then due on such Senior Bonds has been timely paid and (ii) until no Senior Bonds shall remain Outstanding, shall not give rise to any of the remedies of the Indenture as described herein being available to cure any such nonpayment of Subordinate Bonds. A Senior Payment Default will not result in acceleration of any of the Senior Bonds or Subordinate Bonds. Failure to make any Turbo Redemption does not constitute a Subordinate Payment Default or any other Event of Default to the extent that such failure results from an insufficiency of Turbo Available Collections.

Neither the Indenture Trustee nor the Owners shall have the right to sell or foreclose on the Tobacco Assets or the rights of TSASC under the TSR Purchase Agreement.

See "SECURITY FOR THE BONDS—Events of Default and Remedies."

Additional Bonds..... The Indenture permits the issuance of Bonds other than the Series 2017 Bonds, subject to the satisfaction of certain conditions ("**Additional Bonds**", which term includes Bonds issued for the purpose of refunding any Outstanding Bonds ("**Refunding Bonds**"), but excludes any Junior Bonds issued as described below).

Refunding Bonds may be issued to refund all Bonds in whole (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance).

Additional Bonds may be issued for any purpose at the discretion of TSASC, including Refunding Bonds issued to refund Bonds in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance), but only if upon the issuance of such Additional Bonds: (A) no Event of Default shall have occurred and is continuing with respect to (x) if such Additional Bonds proposed to be issued are Senior Bonds, the Senior Bonds then Outstanding or (y) if such Additional Bonds proposed to be issued are Subordinate Bonds, the Subordinate Bonds then Outstanding; (B) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Additional Bonds as computed by TSASC on the basis of new projections on the date of issuance of the Additional Bonds will not exceed (x) the remaining expected weighted average life of each such Turbo Term Bond as computed by TSASC on the basis of new projections assuming that no such Additional Bonds are issued plus (y) one year; and (C) a Rating Confirmation is received for any Bonds that are then rated by a Rating Agency that will remain Outstanding after the date of issuance of the Additional Bonds.

One or more Series of Bonds (the "**Junior Bonds**") may be issued under the Indenture for any lawful purpose if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid. Junior Bonds may be issued without satisfying the requirements described above.

See "SECURITY FOR THE BONDS—Additional Bonds."

Covenants..... Both TSASC and the City have made certain covenants for the benefit of the Bondholders. See APPENDIX I — "DEFINITIONS AND SUMMARY OF THE INDENTURE" for a summary of the covenants made by TSASC and "THE TSR PURCHASE AGREEMENT" for a summary of the covenants made by the City.

Ratings..... The ratings for the rated Series 2017 Bonds address only the likelihood that TSASC will pay the interest on and principal of the rated Series 2017 Bonds when due, and do not address the likelihood that principal may be paid at any faster rate, including by Turbo Redemptions in the case of the Series 2017B Subordinate Bonds. A security 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". The Series 2017B Subordinate Bonds maturing on June 1, 2052* have not been rated.

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

Tax Matters..... In the opinion of Orrick, Herrington & Sutcliffe LLP ("**Transaction Counsel**"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, the interest on the Series 2017 Bonds is: (i) excluded from gross income for federal income tax purposes under Section 103 of the Code, (ii) not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Transaction Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income, and (iii) excluded from adjusted gross income for purposes of personal income taxes imposed by the State and the City to the extent that such interest is excluded from gross income for federal income tax purposes. Transaction Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds. See "TAX MATTERS".

Continuing Disclosure Undertaking..... TSASC has agreed to provide, or cause to be provided, to the Municipal Securities Rulemaking Board, through its Electronic Municipal Market Access system, pursuant to Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission, certain annual financial information and operating data and, in a timely manner, notices of certain events. See APPENDIX H—"FORM OF CONTINUING DISCLOSURE UNDERTAKING."

* Preliminary, subject to change.

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 TSR Purchase Agreement may be obtained by written request from the Indenture Trustee at 101 Barclay Street, 7W, New York, New York 10286.

TSASC Contact..... Mr. Jason Goh
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INTRODUCTORY STATEMENT

This Offering Circular sets forth information concerning the issuance by TSASC, Inc. ("**TSASC**") of its Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior) in the aggregate principal amount of $584,385,000* (the "**Series 2017A Senior Bonds**") and its Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate) in the aggregate principal amount of $440,000,000* (the "**Series 2017B Subordinate Bonds**" and, together with the Series 2017A Senior Bonds, the "**Series 2017 Bonds**"). The Series 2017 Bonds are being issued for the purpose of refunding all of TSASC's outstanding indebtedness. In addition to the Series 2017 Bonds, the below-described Indenture permits the issuance of Additional Bonds, subject to the satisfaction of certain conditions set forth in the Indenture, and also permits the issuance of Junior Bonds, as described herein. The Series 2017 Bonds, together with any Additional Bonds and Junior Bonds issued under the Indenture, are referred to herein as the "**Bonds**."

The Series 2017 Bonds are limited obligations of TSASC and are payable solely from the Pledged TSRs (as hereinafter defined) and the other collateral pledged under the Amended and Restated Indenture, dated as of November 1, 2016 (the "**Indenture**"), between TSASC and The Bank of New York Mellon, as trustee (the "**Indenture Trustee**"). The "**Pledged TSRs**" are the right, title and interest of TSASC in and to 37.40% of the Tobacco Assets (as hereinafter defined). The "**Tobacco Assets**", which were purchased by TSASC from The City of New York (the "**City**"), are all right, title and interest of the City under (i) the Master Settlement Agreement (the "**MSA**") that was entered into by participating tobacco product manufacturers (the "**PMs**") and 46 states (including the State of New York (the "**State**")) and six other U.S. jurisdictions (the "**Settling States**") on November 23, 1998 in settlement of certain smoking-related litigation and (ii) the Consent Decree and Final Judgment related thereto, including the City's right to receive certain Annual Payments (as defined herein) to be made by the PMs under the MSA (such payments and rights, as more fully described herein, are collectively referred to as the "**Tobacco Settlement Revenues**" or "**TSRs**", and include Lump Sum Payments and Total Lump Sum Payments, each as defined herein). Under the MSA, the State is entitled to 12.7620310% of the Annual Payments made by the PMs under the MSA. The Consent Decree and Final Judgment (the "**Decree**"), which was entered into by the Supreme Court of the State of New York in December 1998, allocates this share of the Annual Payments among the State (51.176%), the City (26.670%) and the other counties within the State (22.154%). The MSA resolved all cigarette smoking-related litigation between the Settling States and the PMs and released the PMs from past and present smoking-related claims, and provides for a continuing release of future smoking-related claims in exchange for payments to be made to the Settling States, as well as, among other things, certain tobacco advertising and marketing restrictions. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "NEW YORK CONSENT DECREE".

The State and the PMs entered into a settlement agreement in October 2015 (the "**NY NPM Settlement**") to resolve a long-standing dispute as to the PMs' right to an NPM Adjustment (as described herein) under the MSA, reducing the State's Annual Payments due for each year from 2004 through 2014, and establishing for 2015 and later years sets of circumstances under which the PMs shall be entitled to credits against future payments to the State. Among other things, the NY NPM Settlement substitutes for the NPM Adjustment with respect to the State, two potential credits in favor of the PMs based on NPM sales in the State. Consequently, except in limited circumstances, the State will no longer be subject to the NPM Adjustment provided for in the MSA, but such credits in favor of the PMs may be material. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and "NY NPM SETTLEMENT."

Interest on the Series 2017 Bonds is payable on June 1 and December 1 of each year, commencing June 1, 2017. Principal of the Series 2017 Bonds is payable on the scheduled Maturity Dates as shown on the inside cover hereof. The Series 2017B Subordinate Bonds are Turbo Term Bonds and are subject to Turbo Redemptions as described herein, but failure to make Turbo Redemptions with respect to any Series 2017B Subordinate Bonds will not constitute a Subordinate Payment Default or any other Event of Default (each as defined herein) under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections (as defined herein).

* Preliminary, subject to change.

The Series 2017A Senior Bonds will be senior to the Series 2017B Subordinate Bonds in payment priority under the Indenture, as described herein. See "SECURITY FOR THE BONDS—Application of Collections".

Certain methodologies and assumptions were utilized to establish the amounts, scheduled Maturity Dates and projected Turbo Redemptions of the Series 2017 Bonds. See "TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE," "SERIES 2017B SUBORDINATE BONDS PROJECTED TURBO REDEMPTIONS UNDER VARIOUS CONSUMPTION DECLINE SCENARIOS AND VARIOUS TRIBAL NPM PACK SALES SCENARIOS," "BREAKEVEN CONSUMPTION AND REVENUE DECLINE RATES BY MATURITY" and "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". In addition, the amount and timing of payments on the Series 2017 Bonds may be affected by various factors. See "RISK FACTORS" and "LEGAL CONSIDERATIONS".

SECURITY FOR THE BONDS

Pledge of Collateral

Pursuant to the Indenture, the Bonds will be secured by a first priority pledge of and security interest in the "**Collateral**", consisting of all of TSASC's rights, title and interest, whether now owned or hereafter acquired, in, to and under: (a) the Pledged TSRs and TSASC's right to enforce those covenants made by the City in the TSR Purchase Agreement and described herein under "THE TSR PURCHASE AGREEMENT — Covenants of the City"; (b) the Collections Account (except to the extent that money therein is allocable to the Unpledged TSRs Subaccount, the Operating Account or the Rebate Account), the Debt Service Accounts, the Liquidity Reserve Accounts, the Lump Sum Redemption Account, the Turbo Redemption Account, and all subaccounts contained in such accounts other than the Unpledged TSRs Subaccount in the Collections Account (collectively, the "**Pledged Accounts**"), all money, instruments, general intangibles, investment property, or other property credited to or on deposit in the Pledged Accounts (which excludes money in the Collections Account allocable to the Unpledged TSRs Subaccount, the Operating Account or the Rebate Account) and all investment earnings on amounts on deposit in or credited to the Pledged Accounts; and (c) all present and future claims, demands, causes, and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, general intangibles, and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing. Collateral does not include Unpledged TSRs.

The right of the Indenture Trustee to receive Pledged TSRs is equal to and on a parity with, and is not inferior or superior to, the right of TSASC to receive the Unpledged TSRs. The Indenture Trustee shall have no right to any Unpledged TSRs under any circumstances, including a deficiency in the Pledged TSRs.

Except as specifically provided in the Indenture, the assignment and pledge described above does not include: (i) the rights of TSASC pursuant to provisions for consent or other action by TSASC, notice to TSASC, indemnity or the filing of documents with TSASC, or otherwise for its benefit and not for that of the Beneficiaries or (ii) any right or power reserved to TSASC pursuant to the Local Law or other law; nor does the Indenture preclude TSASC's enforcement of its rights under and pursuant to the TSR Purchase Agreement for the benefit of the Owners.

In the Indenture, TSASC covenants that it will implement, protect and defend the security interest and pledge by all appropriate action for the benefit of the Owners of the Bonds.

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, the Costs of Issuance Account, the Unpledged TSRs Subaccount and the Rebate Account are not pledged as security for the Bonds under the Indenture.

Liquidity Reserve Accounts

A reserve account (the "**Senior Liquidity Reserve Account**") will be established and maintained by the Indenture Trustee under the Indenture and funded on the Closing Date in an amount equal to $45,939,652.78* (the "**Senior Liquidity Reserve Requirement**"), as security for the Series 2017A Senior Bonds and any Additional Bonds secured on parity with the Series 2017A Senior Bonds (collectively, the "**Senior Bonds**"). A reserve account (the "**Subordinate Liquidity Reserve Account**" and, together with the Senior Liquidity Reserve Account, the "**Liquidity Reserve Accounts**") will be established and maintained by the Indenture Trustee under the Indenture and funded on the Closing Date in an amount equal to $20,546,666.67* (the "**Subordinate Liquidity Reserve Requirement**" and, together with the Senior Liquidity Reserve Requirement, the "**Liquidity Reserve Requirements**"), as security for the Series 2017B Subordinate Bonds and any Additional Bonds secured on parity with the Series 2017B Subordinate Bonds (collectively, the "**Subordinate Bonds**"). TSASC is required to maintain the applicable Liquidity Reserve Requirement in the applicable Liquidity Reserve Account, to the extent of funds available for such purpose pursuant to the Indenture.

Amounts on deposit in the Senior Liquidity Reserve Account will be available to pay interest on the Series 2017A Senior Bonds, principal on the respective scheduled Maturity Dates and Mandatory Sinking Fund Installments of the Series 2017A Senior Bonds, to the extent available Collections are insufficient for such purpose. Amounts on deposit in the Subordinate Liquidity Reserve Account will be available to pay interest on the Series 2017B Subordinate Bonds and principal on the respective scheduled Maturity Dates of the Series 2017B Subordinate Bonds, to the extent available Collections are insufficient for such purpose. Amounts in the Liquidity Reserve Accounts will not be available to make Turbo Redemptions of the Series 2017B Subordinate Bonds. Any amount remaining in the respective Liquidity Reserve Account in excess of the respective Liquidity Reserve Requirement will be deposited in the corresponding Debt Service Account.

Application of Collections

The Indenture Trustee shall deposit all funds collected with respect to Pledged TSRs (collectively, "**Collections**") in the Collections Account promptly upon receipt. All Collections that have been identified by an Officer's Certificate as consisting of Lump Sum Payments or Total Lump Sum Payments received by the Indenture Trustee shall be promptly (and, in any event, no later than the Business Day immediately preceding the next following Distribution Date) transferred to the Lump Sum Redemption Account and applied as described under "—Lump Sum Payments and Total Lump Sum Payments" below, in accordance with the instructions received by the Indenture Trustee pursuant to an Officer's Certificate. Amounts constituting Unpledged TSRs will initially be deposited in the Collections Account, and, as confirmed in writing to the Indenture Trustee in an Officer's Certificate, the Indenture Trustee shall promptly deposit such Unpledged TSRs to the Unpledged TSRs Subaccount and then promptly remit such amount to the registered owner of the Residual Certificate.

At any time after making all transfers described above but no later than five Business Days prior to each Distribution Date (as defined herein), the Indenture Trustee shall withdraw Collections on deposit in the Collections Account, including any investment earnings thereon, and transfer to the Operating Account the amounts specified by an Officer's Certificate delivered in order to pay (x) the Operating Expenses in the then current Fiscal Year to the extent that the amount thereof does not exceed, together with amounts previously drawn from the Collections Account for such purpose, the Operating Cap for the then current Fiscal Year, (y) the Operating Expenses for the next succeeding Fiscal Year to the extent that the amount thereof does not exceed the Operating Cap for such Fiscal Year and (z) the Tax Obligations.

Transfers to Accounts

No later than three Business Days prior to each Distribution Date, the Indenture Trustee shall apply amounts in the various Accounts as follows:

* Preliminary, subject to change.

(i) from the Senior Liquidity Reserve Account to the Collections Account, any amount in excess of the Senior Liquidity Reserve Requirement pursuant to the Indenture; and

(ii) unless a Subordinate Payment Default (as defined below) has occurred, from the Subordinate Liquidity Reserve Account to the Subordinate Debt Service Account, any amount in excess of the Subordinate Liquidity Reserve Requirement pursuant to the Indenture.

After making the transfers described above and no later than two Business Days prior to each Distribution Date, the Indenture Trustee shall withdraw the Collections on deposit in the Collections Account, including any investment earnings thereon, and transfer such amounts as follows:

(i) to the Senior Debt Service Account, an amount sufficient to cause the amount therein to equal unpaid interest due on the Outstanding Senior Bonds on the next Distribution Date;

(ii) to the Senior Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (i) above), to equal the principal of Outstanding Senior Bonds due on or prior to the next Distribution Date;

(iii) to the Senior Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clauses (i) and (ii) above), together with any additional amounts in excess of the Senior Liquidity Reserve Requirement required to be transferred or anticipated to be transferred (as determined by an Officer's Certificate) from the Senior Liquidity Reserve Account to the Collections Account as described above, to equal interest due on Outstanding Senior Bonds on the second succeeding Distribution Date;

(iv) to the Senior Liquidity Reserve Account, an amount sufficient to cause the amount therein to equal the Senior Liquidity Reserve Requirement;

(v) if a Subordinate Payment Default has occurred, to the Subordinate Extraordinary Payment Account all amounts remaining in the Collections Account up to the amount required to fully retire all of the Outstanding Subordinate Bonds, including all interest and principal thereon;

(vi) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein to equal interest due on Outstanding Subordinate Bonds on the next Distribution Date;

(vii) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (vi) above), to equal the principal of Outstanding Subordinate Bonds due on or prior to the next Distribution Date;

(viii) to the Subordinate Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clauses (vi) and (vii) above), together with any additional amounts in excess of the Subordinate Liquidity Reserve Requirement required to be transferred or anticipated to be transferred (as determined by an Officer's Certificate) from the Subordinate Liquidity Reserve Account as described above, to equal interest due on Outstanding Subordinate Bonds on the second succeeding Distribution Date;

(ix) to the Subordinate Liquidity Reserve Account, an amount sufficient to cause the amount therein to equal the Subordinate Liquidity Reserve Requirement;

(x) 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 in order to pay, for the current or next succeeding Fiscal Year, Operating Expenses in excess of the Operating Cap up to a maximum of $150,000 for any Fiscal Year;

(xi) to the Turbo Redemption Account, all amounts remaining in the Collections Account up to the amount necessary to redeem all then Outstanding Subordinate Bonds (such amounts, "**Turbo Available Collections**"); and

(xii) to the Surplus Account (which is not a Pledged Account), all amounts remaining in the Collections Account which may then be applied pursuant to an Officer's Certificate to redeem Senior Bonds or make open market purchases of Senior Bonds pursuant to the Indenture, to the extent that Senior Bonds are then Outstanding, or otherwise pursuant to the Residual Certificate.

Distribution Date Transfers

On each Distribution Date, the Indenture Trustee shall apply amounts in the various Accounts in the following order of priority:

(i) from the Senior Debt Service Account and the Senior Liquidity Reserve Account, in that order, to pay interest on the Outstanding Senior Bonds due on such Distribution Date;

(ii) from the Senior Debt Service Account and the Senior Liquidity Reserve Account, in that order, to pay principal of Outstanding Senior Bonds due on or prior to such Distribution Date in chronological order of the date on which such principal is due and Pro Rata within such a principal due date;

(iii) if a Subordinate Payment Default has occurred, from the Subordinate Extraordinary Payment Account, the Subordinate Debt Service Account, the Turbo Redemption Account and the Subordinate Liquidity Reserve Account, if any, to pay Extraordinary Payments (as defined herein) pursuant to the Indenture;

(iv) from the Subordinate Debt Service Account and the Subordinate Liquidity Reserve Account, in that order, to pay interest on the Outstanding Subordinate Bonds due on such Distribution Date;

(v) from the Subordinate Debt Service Account and the Subordinate Liquidity Reserve Account, in that order, to pay principal of Outstanding Subordinate Bonds due on such Distribution Date in chronological order of the date on which such principal is due and Pro Rata within such a principal due date; and

(vi) from the Turbo Redemption Account, to make Turbo Redemption payments on Subordinate Turbo Term Bonds in accordance with the Indenture.

Payment Defaults

Upon the occurrence of any failure to pay when due any principal or interest on any Senior Bonds (a "**Senior Payment Default**"), all Pledged TSRs (after payment of Indenture Trustee fees and other Operating Expenses up to the Operating Cap) will be applied solely to funding the Senior Debt Service Account, and replenishing the Senior Liquidity Reserve Account, until all payments of interest on, Mandatory Sinking Fund Installments on, and maturing principal of the Senior Bonds are current and all such Accounts fully funded as described above, after which any remaining Pledged TSRs may be applied to payment of amounts due on any Outstanding Subordinate Bonds.

Upon the occurrence of any failure to pay when due any principal or interest on any Subordinate Bonds (a "**Subordinate Payment Default**") and continuing on each succeeding Distribution Date commencing with the Distribution Date following such Subordinate Payment Default, the Indenture Trustee shall apply all funds in the Subordinate Extraordinary Payment Account, the Subordinate Debt Service Account (if any), the Subordinate Liquidity Reserve Account (if any) and the Turbo Redemption Account (if any) to pay (or prepay) with respect to the Subordinate Bonds, Pro Rata, without regard to their order of maturity, in the following order: (i) past due interest on the Subordinate Bonds, (ii) accrued and unpaid interest on the Subordinate Bonds, and (iii) principal of the Subordinate Bonds without premium ("**Extraordinary Payments**"). Failure to make Turbo Redemptions with respect to Turbo Term Bonds will <u>not</u> constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections.

Lump Sum Payments and Total Lump Sum Payments

Upon the receipt of a sum that has been identified by an Officer's Certificate as a "**Lump Sum Payment**" (a payment from a PM that results in, or is due to, a release of that PM from all or a portion of its future payment obligations under the MSA, but not including any payments that are Total Lump Sum Payments, any non-scheduled prepayments other than a Lump Sum Payment or any payments made with respect to prior payment obligations), on the next Distribution Date following such receipt, the Indenture Trustee shall transfer all proceeds of such Lump Sum Payment to the Lump Sum Redemption Account to pay, in the following order: (i) past due interest on the Senior Bonds, Pro Rata, (ii) accrued and unpaid interest on the Senior Bonds, Pro Rata, (iii) principal of the Senior Bonds without premium, in chronological order of the date on which such principal is due and Pro Rata within such a principal due date, (iv) past due interest on the Subordinate Bonds, Pro Rata, (v) accrued and unpaid interest on the Subordinate Bonds, Pro Rata and (vi) principal of the Subordinate Bonds without premium, in chronological order of the date on which such principal is due and Pro Rata within such a principal due date.

Upon the receipt of a sum that has been identified by an Officer's Certificate as a "**Total Lump Sum Payment**" (a final payment from all of the PMs that results in, or is due to, a release of all of the PMs from all of their future payment obligations under the MSA), the Indenture Trustee shall transfer all proceeds of such Total Lump Sum Payment to the Lump Sum Redemption Account to pay, in the following order: (i) past due interest on the Senior Bonds, Pro Rata, (ii) accrued and unpaid interest on the Senior Bonds, Pro Rata, (iii) principal of the Senior Bonds without premium, in chronological order of the date on which such principal is due and Pro Rata within such a principal due date, (iv) past due interest on the Subordinate Bonds, Pro Rata, (v) accrued and unpaid interest on the Subordinate Bonds, Pro Rata and (vi) principal of the Subordinate Bonds without premium, Pro Rata, irrespective of any principal due date.

Other Applications

After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds, the Indenture Trustee shall deliver any amounts remaining in a Fund or Account to the Unpledged TSRs Subaccount.

Funds in the Operating Account shall be applied by the Indenture Trustee at any time, in accordance with directions in an Officer's Certificate, to pay Operating Expenses or to fund an account of TSASC which will also be free and clear of the lien of the Indenture for purposes of paying such Operating Expenses.

City Covenant

TSASC includes in the Indenture the City's pledge and agreement with the Owners that the City will not limit or alter the rights of TSASC to fulfill the terms of its agreements with such Owners, or in any way impair the rights and remedies of such Owners or the security for such Bonds until such Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Owners, are fully paid and discharged.

Events of Default and Remedies

Events of Default

An "**Event of Default**" under the Indenture means any one of the following events:

(a) a Senior Payment Default;

(b) a Subordinate Payment Default;

(c) failure of TSASC to observe or perform any other covenant, condition, agreement, or provision contained in the Bonds or in the Indenture (other than the covenant to comply with the applicable continuing disclosure undertaking), which failure is not remedied within 60 days after Written Notice, specifying such default

and requiring the same to be remedied, shall have been given to TSASC by the Indenture Trustee or by the Owners of at least 25% in principal amount of the Bonds then Outstanding; provided, however, if the default be such that it cannot be corrected within the 60-day period, it shall not constitute an Event of Default if corrective action is instituted by TSASC within the 60-day period and diligently pursued until the default is corrected; and

(d) failure of the City to observe or perform its non-impairment covenant, described above in "City Covenant", which failure is not remedied within 60 days after Written Notice thereof is given by the Indenture Trustee to the City and TSASC or by TSASC to the Indenture Trustee and the City, if a majority of the Owners of the then Outstanding Bonds declares an Event of Default; provided, however, if the default be such that it cannot be corrected within the 60-day period, it shall not constitute an Event of Default if corrective action is instituted by TSASC within the 60-day period and diligently pursued until the default is corrected.

Notwithstanding the foregoing, a Subordinate Payment Default (i) shall not cause any Senior Bonds to be deemed to be in default if the payment of all interest and principal then due on such Senior Bonds has been timely paid and (ii) until no Senior Bonds shall remain Outstanding, shall not give rise to any of the remedies of the Indenture as described herein being available to cure any such nonpayment of Subordinate Bonds.

Remedies

If an Event of Default occurs:

(i) The Indenture Trustee may, and upon written request of the Owners of at least 25% in principal amount of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with law: (A) enforce all rights of the Owners and require TSASC or the City to carry out their respective agreements under the Bonds, the Indenture or the TSR Purchase Agreement; (B) sue upon such Bonds; (C) require TSASC to account as if it were the trustee of an express trust for such Owners; and (D) enjoin any acts or things which may be unlawful or in violation of the rights of such Owners.

(ii) The Indenture Trustee shall, in addition to the other provisions set forth in the Indenture, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Owners in the enforcement and protection of their rights.

(iii) Upon an Event of Default described in clause (a) or (b) of "Events of Default" above, or a failure to make any other payment required under the Indenture within 7 days after the same becomes due and payable, the Indenture Trustee shall give Written Notice thereof to TSASC. The Indenture Trustee shall give notice under clause (c) or (d) of "Events of Default" above when instructed to do so by the written direction of another Fiduciary or the Owners of at least 25% in principal amount of the Outstanding Bonds. Upon the occurrence of an Event of Default, the Indenture Trustee shall proceed under the Indenture for the benefit of the Owners in accordance with the written direction of a Majority in Interest of the Outstanding Bonds. The Indenture 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 Indenture Trustee shall promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Owners, and shall act for the protection of the Owners with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Upon the occurrence of a Senior Payment Default or a Subordinate Payment Default, as applicable, funds shall be applied as described under "—Application of Collections—Payment Defaults."

Neither the Indenture Trustee nor the Owners shall have the right to sell or foreclose on the Tobacco Assets or the rights of TSASC under the TSR Purchase Agreement.

Additional Bonds

The Indenture permits the issuance of Bonds other than the Series 2017 Bonds, subject to the satisfaction of certain conditions ("**Additional Bonds**", which term includes Bonds issued for the purpose of refunding any Outstanding Bonds ("**Refunding Bonds**"), but excludes any Junior Bonds issued as described below).

Refunding Bonds may be issued to refund all Bonds in whole (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance).

Additional Bonds may be issued for any purpose at the discretion of TSASC, including Refunding Bonds issued to refund Bonds in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance), but only if upon the issuance of such Additional Bonds: (A) no Event of Default shall have occurred and is continuing with respect to (x) if such Additional Bonds proposed to be issued are Senior Bonds, the Senior Bonds then Outstanding or (y) if such Additional Bonds proposed to be issued are Subordinate Bonds, the Subordinate Bonds then Outstanding; (B) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Additional Bonds as computed by TSASC on the basis of new projections on the date of issuance of the Additional Bonds will not exceed (x) the remaining expected weighted average life of each such Turbo Term Bond as computed by TSASC on the basis of new projections assuming that no such Additional Bonds are issued plus (y) one year; and (C) a Rating Confirmation is received for any Bonds that are then rated by a Rating Agency that will remain Outstanding after the date of issuance of the Additional Bonds.

One or more Series of Bonds (the "**Junior Bonds**") may be issued under the Indenture for any lawful purpose if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid. Junior Bonds may be issued without satisfying the requirements described above.

Limited Obligations; No Indebtedness or Funds of City

The Bonds are limited obligations of TSASC and payable solely from the Pledged TSRs and the other collateral pledged under the Indenture. The Bonds are not debt of the State or the City, and neither the State nor the City is liable thereon. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, the revenues nor the taxing power of the State or the City is, or shall be deemed to be, pledged to the payment of any of the Bonds. TSASC has no taxing power.

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

RISK FACTORS

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

The discussion of certain risks has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies, including Altria Group, Inc., Reynolds American, Inc. and Vector Group Ltd., currently file annual, quarterly and certain other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-8090; e-mail: publicinfo@sec.gov).

The list of risks set forth herein is not a complete list of the risks associated with the Pledged TSRs, nor does the order of presentation necessarily reflect the relative importance of the various and separate risks. Certain general categories of risks discussed below include, among others, payment decreases under the terms of the MSA and the NY NPM Settlement, declines in cigarette consumption, litigation and bankruptcy. There can be no

assurance that other risk factors will not become material in the future. See also "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT," "NY NPM SETTLEMENT," "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" and APPENDIX A—"IHS GLOBAL REPORTS." Additional risk factors are set forth in "LEGAL CONSIDERATIONS."

Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. Any such adjustment could trigger the Offset for Miscalculated or Disputed Payments.

In October 2015, the State and the PMs that were party to a dispute with the State over NPM Adjustments for years 2004-2014 entered into the NY NPM Settlement, which substitutes for the NPM Adjustment with respect to the State, other adjustments based on information and certain estimations of certain NPM cigarette sales in the State, which adjustments could be material. See "—Tribal NPM Packs Credit Under the NY NPM Settlement" and "—Possible Future Non-Compliant SET-Paid NPM Sales Credit" below. For additional information regarding the MSA, the NY NPM Settlement, and the payment adjustments thereunder, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments," "NY NPM SETTLEMENT," and "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES".

Any such adjustments could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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

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

The State received as part of its April 2014 MSA payment formerly disputed amounts attributable to the 2003 NPM Adjustment and the City received its allocation in accordance with the Decree. The payment of the formerly disputed amounts was due to the September 2013 decision by a panel of three former federal judges arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") that the State diligently enforced its Qualifying Statute in 2003.

In April 2016, the State received under the terms of the NY NPM Settlement $660,510,408.80 (net of $141,492,961.09 of credits to the SA PMs (as defined herein) provided under the NY NPM Settlement) released from the DPA with respect to NPM Adjustment claims by the SA PMs for years 2004 through 2014. The NY NPM Settlement, among other things, resolved disputes between the State and the OPMs and certain SPMs with respect to the NPM Adjustment for years 2004 through 2014. See "NY NPM SETTLEMENT."

The funds released represented most of the State's share of over $9.1 billion that, according to NAAG, the Settling States and one or more of the PMs are disputing or have disputed relating to the calculations of some Annual Payments and Strategic Contribution Payments[(*)] for the sales years 2004 through 2014, including payments due, moneys withheld outright, moneys deposited to the DPA, or, as in the case of the largest OPM (Philip Morris), moneys actually paid by the OPM to the Settling States, but with the OPM asserting a reservation of right to dispute such amount paid pursuant to the MSA. The $9.1 billion total includes amounts with respect to which the PMs have

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(*) The Pledged TSRs include only Annual Payments and do not include any Strategic Contribution Payments.

stated they have filed dispute notices and significant additional amounts that the PMs have indicated may lead to claimed reductions in their MSA payments due in future years.

By virtue of the NY NPM Settlement, Annual Payments due to the State under the MSA for cigarette sales in 2015 and later years will no longer to subject to adjustments based on the NPM Adjustment under the MSA (except in limited circumstances), but will be subject to two potential credits in favor of the PMs described in the NY NPM Settlement based on actual and estimated cigarette sales in the State. See "NY NPM SETTLEMENT."

Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. Except for a projected annual credit to the PMs under the terms of the NY NPM Settlement for Tribal NPM Packs based on the IHS Global Tribal Sales Report, the Pledged TSRs Projection Methodology and Assumptions described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" do not factor in any credit under the NY NPM Settlement or any offset for any future miscalculated or disputed payments under the MSA or any release of funds currently held in the DPA (except as provided by the NY NPM Settlement). Adjustments in future Pledged TSRs (including adjustments relating to credits under the NY NPM Settlement, made in the form of a credit against future MSA payments) could be different from those projected.

See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments–*Offset for Miscalculated or Disputed Payments*" and "NY NPM SETTLEMENT".

Growth of NPM Market Share and Other Factors

Should a decline in cigarette consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments by the PMs due to application of the Volume Adjustment, even for Settling States that have negotiated with the PMs alternative arrangements to the NPM Adjustment (including the State and the NY NPM Settlement) or have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. Such reductions of Annual Payments could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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

Tribal NPM Packs Credit Under the NY NPM Settlement

The NY NPM Settlement provides for an annual credit of $90 million against the aggregate Annual Payments due from the OPMs in each of 2016 through 2019 based on a stipulated amount of Tribal NPM Packs (namely, 150 million packs) sold in the State in, respectively, each of 2011 through 2014 (which stipulated amount, the NY NPM Settlement provides, is not claimed by any party to represent actual Tribal NPM Packs sales), and a $0.60 per pack credit. As used in the NY NPM Settlement, "**Tribal NPM Packs**" are packs of cigarettes sold without payment of State cigarette tax on or from Native American reservations in the State to State consumers (other than the Native Americans who reside on the reservation in question). In addition, the NY NPM Settlement provides each of the SPMs who signed the NY NPM Settlement (a "**Settlement Agreement SPM**" or "**SA SPM**") with a credit in each of 2017 through 2019 equal to the product of $90 million multiplied by a fraction, the numerator of which is such SA SPM's Potential Maximum NPM Adjustment (as defined in the NY NPM Settlement) to which the SA SPMs is entitled for each of 2012 through 2014 and the denominator of which is the Potential Maximum NPM Adjustment (as defined in the NY NPM Settlement) to which the OPMs collectively are entitled to for each of 2012 through 2014. See "NY NPM SETTLEMENT." These credits are referred to herein as

"**Fixed Tribal NPM Packs Credits**". For years 2017, 2018 and 2019, the Fixed Tribal NPM Packs Credits for both the OPMs and SA SPMs will be increased by interest at the Prime Rate from April 15, 2016.

Under the NY NPM Settlement, the OPMs and the SA SPMs (collectively, the "**Settlement Agreement PMs**" or "**SA PMs**") are also entitled to a credit for estimated sales of Tribal NPM Packs in 2015 and each later year, with the credit to be available against the Annual Payments due in the second succeeding year (for example, the credit for 2015 is available against the 2017 Annual Payment). For purpose of this credit, referred to herein as the "**Variable Tribal NPM Packs Credit**," the determination of estimated Tribal NPM Packs sales is to be made by an Investigator (as hereinafter defined) selected jointly by the State and the SA PMs (or as otherwise described in the NY NPM Settlement). The Variable Tribal NPM Packs Credit is determined based on the estimated number of Tribal NPM Packs sold as determined by the Investigator and a per pack credit amount that starts at $0.47 per pack for fewer than 50 million Tribal NPM Packs sold in a year and increases to $0.70 per pack for 125 million or more Tribal NPM Packs sold in a year. Such per pack credits are subject to adjustment in accordance the inflation adjustment of the MSA (with 2015 as the base year). See "NY NPM SETTLEMENT."

There is no available and reliable source of information as to the number of Tribal NPM Packs sold in the State, and the Investigator's determination of Tribal NPM Packs sold in 2015 will be the first of its kind under the NY NPM Settlement.

For the Pledged TSRs Projection Methodology and Assumptions described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS", the annual Variable Tribal NPM Packs Credit for sales year 2015 and later is calculated assuming annual Tribal NPM Packs sales as forecast in the IHS Global Tribal Sales Report. That report estimates Tribal NPM Packs sales of 54.2 million packs in 2015 and 49.8 million in 2016, with decreases in subsequent years based in part on the forecast of cigarette consumption set forth in the IHS Global Consumption Report.

The application of the Fixed Tribal NPM Packs Credits and Variable Tribal NPM Packs Credits could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

Furthermore, if estimated Tribal NPM Packs sales as determined by the Investigator selected by the State and the PMs are materially greater than the sales forecast in the IHS Global Tribal Sales Report, the Pledged TSRs available to TSASC may be materially below the levels forecast on the basis of the Pledged TSRs Projection Methodology and Assumptions described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". See "NY NPM SETTLEMENT" and "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES."

See also "LEGAL CONSIDERATIONS—MSA and Qualifying Statute Enforceability."

Variable Tribal NPM Packs Credits Under the NY NPM Settlement Are Uncertain

Data on the quantity of Tribal NPM Packs sold is not disclosed by the State's Native Americans[(*)] and is not otherwise publicly available. See "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES—Legal Considerations Relating to Collection of State Cigarette Tax on Tribal Sales." Consequently, any determination of Tribal NPM Packs sales must be an estimate derived from an evaluation of other information that is publicly available. The methodology and assumptions used by IHS Global in developing its estimate of 2015 Tribal NPM Packs sales and in projecting future Tribal NPM Packs sales is described in the IHS Global Tribal Sales Report. The 2015 estimate and the future projections of IHS Global will not be used by the State and the PMs for purposes of determining the Variable Tribal NPM Packs Credit. For purposes of the NY NPM Settlement, Tribal NPM Packs sales for 2015 and later years will be estimated every two years by an investigator to be selected jointly by the State and the OPMs every four years (the "**Investigator**"). The selection of the Investigator to estimate 2015 Tribal NPM Packs sales has not been announced. The Investigator's estimation of Tribal NPM Packs sales for 2015 will be the

(*) Excepting only the Oneida Nation, which provides sales information to the State under the Oneida Nation Agreement. See "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES—Oneida Nation Agreement."

first of its kind under the NY NPM Settlement, and the estimations of the Investigator are conclusive and final under the NY NPM Agreement. The NY NPM Settlement does not prescribe the methodology or assumptions to be used by the Investigator. Consequently, the Investigator may use different methodology, may consider different information, may make different assumptions, and may come to a materially different estimation of Tribal NPM Packs sales for 2015 and later years than the IHS Global estimation and projection. If estimated Tribal NPM Packs sales as determined by the Investigator are materially greater than the sales forecast in the IHS Global Tribal Sales Report, then the Pledged TSRs may be materially below the levels forecast on the basis of the Pledged TSRs Projection Methodology and Assumptions described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and may not be sufficient to provide for the payment of debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "NY NPM SETTLEMENT," "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES" and APPENDIX A-2—"IHS GLOBAL TRIBAL SALES REPORT."

Tribal NPM Packs Sales Affected by Numerous Factors

The Variable Tribal NPM Packs Credit for 2015 (to be taken in 2017) and later years is based on estimated sales of Tribal NPM Packs to State non-tribal consumers on, from or through Native American reservations in the State, including NPM cigarettes manufactured on the reservations, without payment of State cigarette excise tax ("**SET**"). At any time, the level of such sales may rise as a result of any one of numerous factors, including State and local cigarette taxes, accessibility of tribal cigarette outlets, price and quality of Tribal NPM Packs, and other factors, which could cause an increase in the amount of such sales estimated by the Investigator for purposes of determining the Variable Tribal Packs Credit under the NY NPM Settlement. See "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES".

Possible Future Non-Compliant SET-Paid NPM Sales Credit

If there is an increased level of non-compliance by NPMs with the escrow deposit requirement of the State's Qualifying Statute, the Annual Payments to the State by PMs under the MSA may be decreased as a result of the Non-Compliant SET-Paid NPM Sales Credit under the NY NPM Settlement. While historically, as reported by the State's Attorney General's office, the rate of non-compliance has been within the safe-haven created under the NY NPM Settlement to allow the State to totally avoid the Non-Compliant SET-Paid NPM Sales Credit (either (a) the total number of Non-Compliant SET-Paid NPM Cigarettes sold during the year did not exceed 4% of all NPM cigarettes on which SET was paid during the year or (b) the total number of Non-Compliant SET-Paid NPM Cigarettes sold during the year did not exceed two million cigarettes), there can be no assurance that such historic rates of non-compliance will continue in the future. Greater non-compliance by NPMs with the escrow deposit requirement of the State's Qualifying Statute could result in the application of the Non-Compliant SET-Paid NPM Sales Credit, reducing Annual Payments to the State and in turn the amount of Pledged TSRs, which could materially adversely affect the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "NY NPM SETTLEMENT—Credit to Settlement Agreement PMs for Sales in the State of Certain NPM Cigarettes–*Non-Compliant SET Paid NPM Sales Credit*." The Pledged TSRs Projection Methodology and Assumptions include the assumption that the Non-Compliant SET-Paid NPM Sales Credit will be zero in all future years. See "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS." No assurance can be given that this assumption will be accurate for all years in which the Series 2017 Bonds are Outstanding.

Possible Reimposition of NPM Adjustment

Under the NY NPM Settlement, if in any future year (a) the number of NPM cigarettes sold in the State on which SET was paid is 40 million or more and (b) at least 20% of such SET-paid NPM cigarettes are Non-Compliant SET-Paid NPM Cigarettes (due to non-compliance with the escrow requirement of the State's Qualifying Statute), the SA PMs will have the option of either receiving the Non-Compliant SET-Paid NPM Sales Credit for the year or seeking to apply the NPM Adjustment under the MSA for the year. The NPM Adjustment shall be applied only if SA PMs representing 87% of aggregate Market Share under the MSA for the year so choose. If chosen, the NPM Adjustment will be applied subject to the procedures, standards and exemptions under the MSA, subject to certain exceptions, including agreement of the SA PMs not to assert that the State was not diligently enforcing its Qualifying Statute for the year based on the State's non-collection of SET on Tribal NPM Cigarettes sold to State

non-tribal consumers. See "STATE LAWS RELATED TO MSA—State Enforcement Agencies," "NY NPM SETTLEMENT" and APPENDIX D—"NY NPM SETTLEMENT."

Declines in Cigarette Consumption

Cigarette consumption in the U.S. has declined significantly over the last several decades. According to a report issued by the Centers for Disease Control ("**CDC**") in 2016, using data from the 2014 National Health Interview Survey, the smoking rate for adults in the United States fell to approximately 15.1% in 2015, from 16.8% in 2014, and from 20.9% in 2004. NAAG, in its report relating to MSA payments for 2015, reports total industry domestic cigarette shipment volume of 270.8 billion cigarettes (as compared to shipments of approximately 400 billion in 2003, according to the IHS Global Consumption Report). See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Cigarette Shipment Trends."

Payments under the MSA are determined in part by the volume of cigarettes sold by the PMs in the U.S. cigarette market. U.S. cigarette consumption in recent years has been reduced because of price increases, restrictions on advertising and promotions, increases in excise taxes, smoking bans in public places, the raising of the minimum age to possess or purchase tobacco products, other increased regulation such as state and local bans on characterizing flavors, a decline in the social acceptability of smoking, health concerns, funding of smoking prevention campaigns, increased pressure from anti-tobacco groups, increased usage of alternative products such as e-cigarettes and other vapor products, curtailments in the chain of distribution, and other factors. U.S. cigarette consumption is expected to continue to decline for the reasons stated above and others. Continuing declines in cigarette consumption could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. The following factors, among others, may negatively impact cigarette consumption in the U.S.

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

The Family Smoking Prevention and Tobacco Control Act (the "**FSPTCA**"), signed by President Obama on June 22, 2009, granted the FDA broad authority over the manufacture, sale, marketing and packaging of tobacco products. The legislation, among other things, requires larger and more severe health warnings on cigarette packs and cartons, bans the use of certain descriptors on tobacco products, requires the disclosure of ingredients and additives to consumers, and allows the FDA to place more severe restrictions on the advertising, marketing and sales of cigarettes. Since the passage of the FSPTCA, the FDA, among other things, has prohibited fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban), prohibited misleading marketing terms ("Light," "Low," and "Mild") for tobacco products, rejected applications for the introduction of new tobacco products into the market, and issued its final rule subjecting e-cigarettes and certain other tobacco products to FDA regulations. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues—FSPTCA."

Tobacco manufacturers have filed suit regarding certain provisions of the FSPTCA and actions taken thereunder. In August 2009, a group of tobacco manufacturers (including Reynolds Tobacco and Lorillard) and a tobacco retailer filed a complaint against the United States in the U.S. District Court for the Western District of Kentucky, *Commonwealth Brands, Inc. v. U.S.*, in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. In March 2012, the U.S. Court of Appeals for the Sixth Circuit affirmed the district court's earlier decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. However, the Sixth Circuit affirmed the district court's grant of summary judgment to plaintiff manufacturers on the unconstitutionality of the FSPTCA's restriction of tobacco advertising to black and white text. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case.

On June 22, 2011, the FDA issued a final regulation for the imposition of larger, graphic health warnings on cigarette packaging and advertising, which was scheduled to take effect September 22, 2012 (but which the FDA

is currently enjoined from enforcing, as described below). On August 16, 2011, five tobacco companies (including Reynolds Tobacco and Lorillard) filed a lawsuit against the FDA in the U.S. District Court for the District of Columbia, *R. J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration*, challenging the FDA's final regulation specifying nine new graphic "warnings" pursuant to the FSPTCA and seeking a declaratory judgment that the final regulation violates the plaintiffs' rights under the First Amendment to the U.S. Constitution and the Administrative Procedure Act ("**APA**"). On August 24, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed a February 29, 2012 decision of the district court that invalidated the graphic warning rule. On March 19, 2013, the FDA announced that it would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA and would propose a new graphic warnings rule in the future. The FDA has not provided a timeline for a new rule. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case and several other cases.

The FDA has yet to issue guidance with respect to many provisions of the FSPTCA. It is likely that future regulations promulgated by the FSPTCA, including regulation of menthol short of an outright ban thereof, as discussed below, could result in a decrease in cigarette sales in the U.S., and an increase in costs to PMs, potentially resulting in a material adverse effect on the PMs' financial condition, results of operations and cash flows. Additionally, the FDA's rules regarding clearance for new or modified cigarette products brand names could adversely impact PMs' access to the market. The negative impact of the foregoing factors could be to reduce consumption of cigarettes in the U.S., thereby reducing payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

Concerns that Mentholated Cigarettes May Pose Greater Health Risks Could Result in Further FDA Regulation Which Could Materially Adversely Affect the Volume of Cigarettes Sold in the U.S. and Thus Payments Under the MSA

Some plaintiffs and constituencies, including public health agencies and non-governmental organizations, have claimed or expressed concerns that mentholated cigarettes may pose greater health risks than non-mentholated cigarettes, including concerns that mentholated cigarettes may make it easier to start smoking and harder to quit, and increase smoking initiation among youth and the incidence of smoking among youth. Such plaintiffs and constituencies may seek restrictions or a ban on the production and sale of mentholated cigarettes. On November 8, 2013, twenty-seven states (including the State) sent a letter to the FDA in support of a ban on menthol-flavored cigarettes. In an August 2016 letter, the African American Tobacco Control Leadership Council asked President Obama to direct the FDA to issue a proposed rule to remove all flavored tobacco products, including mentholated cigarettes, from the marketplace. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs that sell large quantities of mentholated cigarettes, especially Reynolds Tobacco, a significant portion of whose sales, after the merger with Lorillard, are dependent on the Newport brand of mentholated cigarettes.

The FSPTCA established the Tobacco Products Scientific Advisory Committee ("**TPSAC**") and directs the TPSAC to evaluate issues surrounding the use of menthol as a flavoring or ingredient in cigarettes. In addition, the legislation permits the FDA to ban menthol upon a finding that such a prohibition would be appropriate for the public health. The TPSAC or the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At a March 2011 meeting, TPSAC presented its findings that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." On July 23, 2013, the FDA released a preliminary evaluation on menthol cigarettes, finding among other things that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. The FDA is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues–*FSPTCA Litigation*" for a discussion on litigation regarding the TPSAC.

If the FDA determines that the regulation of menthol is warranted, the FDA could promulgate regulations that, among other things, could result in a ban on or a restriction on the use of menthol in cigarettes. A ban or any material restriction on the use of menthol in cigarettes could adversely affect the overall sales volume of cigarettes by the PMs, thereby reducing payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

The Volume of Cigarettes Sold by PMs in the U.S. Cigarette Market is Expected to Continue to Decline as a Result of Increases in Cigarette Excise Taxes

In the U.S., tobacco products are subject to substantial and increasing federal and state excise taxation, which has a negative effect on consumption. On April 2, 2009, Congress increased the federal excise tax per pack of cigarettes to $1.01 per pack (an increase of $0.62), and significantly increased taxes on other tobacco products. President Obama's 2017 federal budget proposal, released in early February 2016, includes a proposed increase in the federal excise tax on a pack of cigarettes to $1.95 per pack (and proposed proportionate increases in all other tobacco product tax rates). All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2015 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.39. In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold, such as New York, Philadelphia and Chicago. According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, between the end of 1998 (the year that the MSA was executed) and October 24, 2016, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.61 per pack. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, during the first nine months of 2016, 19 states proposed legislation to increase cigarette excise taxes, with legislation being enacted in three states (Louisiana, Pennsylvania and West Virginia) and failing in 16 states. In California, a proposal to increase the State's cigarette excise tax by $2.00 per pack (in addition to that state's current $0.87 per pack excise tax) is on the ballot for November 2016. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues–*Excise Taxes*" for a further description of excise taxes on cigarettes.

It is expected that states and local governments will continue to raise excise taxes on cigarettes in 2016 and future years. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands, deep discount brands, untaxed cigarettes sold on certain Native American reservations and duty-free shops, counterfeit brands or pipe tobacco for roll-your-own consumers. Reductions in consumption or, in the State, consumers switching to untaxed NPM cigarettes sold on Native American reservations, will lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

The Volume of Cigarettes Sold by PMs in the U.S. Cigarette Market is Expected to Continue to Decline Because of Efforts to Raise the Minimum Age for Purchase and Possession of Cigarettes

U.S. cigarette consumption is expected to continue to decline due to legislative efforts to raise the minimum age to possess or purchase tobacco products. All states and the District of Columbia have enacted statutes generally prohibiting the sale of tobacco products to individuals under the age of 18. The minimum age to purchase tobacco products rose to 21 in the State of Hawaii as of January 1, 2016 (the first state to do so) and California in June 2016. Twenty-one is the minimum age to purchase tobacco products in New York City, Suffolk County, Boston, Chicago, Cleveland, and both Kansas Cities. Similar proposals to raise the smoking age have also been introduced in the legislatures of Colorado, Massachusetts, Missouri, New Jersey, New York State, Ohio, Pennsylvania, Rhode Island, Utah, Vermont, and Washington, and in the Council of the District of Columbia, according to the IHS Global Consumption Report. Four states, Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19, according to the IHS Global Consumption Report. On March 12, 2015, the Institute of Medicine of the National Academy of Sciences released a report recommending that

the minimum age of legal access to tobacco products be raised to 21. The report concluded that raising the minimum legal age to 21 would likely decrease smoking prevalence by 12% among today's teenagers when they become adults. In October 2015, the American Academy of Pediatrics issued a policy statement strongly recommending that the age for the purchase of tobacco products be raised to 21 as a means to decrease reduce youth smoking rates. Declines in consumption due to increasing the minimum age to possess or purchase tobacco products could lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

Increased Restrictions on Smoking in Public Places Could Adversely Affect U.S. Tobacco Consumption and Therefore Amounts to be Paid Under the MSA

In recent years, federal, state and many local and municipal governments and agencies, as well as private businesses, have adopted legislation, regulations, insurance provisions or policies which prohibit, restrict, or discourage smoking generally, smoking in public buildings and facilities, stores, restaurants and bars, and smoking on airline flights and in the workplace. Other similar laws and regulations are currently under consideration and may be enacted by state and local governments in the future. Restrictions on smoking in public and other places may lead to a decrease in the number of people who smoke or a decrease in the number of cigarettes smoked or both. Smoking bans have recently been extended by many state and local governments to outdoor public areas, such as beaches, parks and space outside restaurants, and others may do so in the future. Increased restrictions on smoking in public and other places have caused a decrease, and may continue to cause a decrease, in the volume of cigarettes that would otherwise be sold in the U.S. absent such restrictions, which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues–*State and Local Regulation.*"

Several of the PMs and Their Competitors have Developed Alternative Tobacco and Cigarette Products, Including Electronic Cigarettes and Vaporizers, Sales of Which Do Not Currently Result in Payments Under the MSA

Certain of the major cigarette makers have developed (or acquired) and marketed alternative cigarette products the shipments of which do not give rise to payment obligations under the MSA. For example, numerous manufacturers have developed and are marketing "electronic cigarettes" or "e-cigarettes," which are not tobacco products but are battery powered devices that vaporize liquid nicotine which is then inhaled. E-cigarettes do not currently constitute "cigarettes" within the meaning of the MSA (as deemed by the manufacturers and certain states) because they do not contain or burn or heat tobacco. The fastest growth in this area comes from devices called "vaporizers", which are larger, customizable devices that hold more liquid, produce larger vapor clouds and last longer. They allow users to mix and match hardware and refill cartridges with liquid bought in bulk, so that they are cheaper than e-cigarettes. E-cigarettes and other vapor products are currently not subject to the advertising restrictions to which tobacco products are subject. In addition, most jurisdictions do not subject electronic cigarettes or other vapor products to excise taxes.

According to the IHS Global Consumption Report, U.S. sales of electronic cigarettes in 2015 have been estimated at over $4 billion, having increased rapidly. The CDC in September 2014 reported results of a survey that indicated that in 2013 approximately 8.5% of the adult population (representing approximately two-and-a-half times the 2010 estimates), and 36.5% of smokers (representing approximately four times the 2010 estimates), had tried e-cigarettes at some time. The CDC in June 2016 released survey results showing that 45% of high school students had tried e-cigarettes in 2015, compared with only 32% who had tried cigarettes. In April 2016, the CDC's National Youth Tobacco Survey found that e-cigarette use among high school students had increased to 16% in 2015, from 1.5% in 2011. In December 2014 the University of Michigan's Survey for Research Center reported its findings that e-cigarette use exceeded traditional cigarette smoking among teens in 2014.

On May 5, 2016, the FDA released its final rule which subjects manufactures, importers and/or retailers of e-cigarettes and certain other tobacco related products (including cigars and pipe tobacco) to the same and, in some cases additional, regulations applicable to cigarettes, cigarette tobacco and smokeless tobacco. Among other things,

the rule bans sales of e-cigarettes and other vapor products, cigars, hookah tobacco, pipe tobacco and other products to people under 18 and requires new health warnings for these products. In addition, manufacturers must seek federal permission to continue marketing all e-cigarettes and other such products launched since 2007 (making up virtually all of the market). The rule does not restrict flavored products, online sales or advertising. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues–*FSPTCA*." No assurance can be given that regulation of e-cigarettes by the FDA will alter the trend of increased sales of e-cigarettes.

Cigarette manufacturers also market other types of alternative products, such as moist snuff, "snus" (a smokeless, spitless tobacco product that originated in Sweden), disposable nicotine discs, and dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased by 65.6% between 2005 and 2011, according to the National Center for Biotechnology Information. A June 2014 report by the CDC found that smokeless tobacco use among U.S. workers has remained relatively steady since 2005, with 2.7% of U.S. workers using smokeless tobacco products in 2005 and 3.0% of U.S. workers using smokeless tobacco products in 2010, while cigarette use has declined since 2005.

Electronic cigarettes, vapor products and smokeless tobacco products are viewed by some as alternatives to cigarette smoking that may lead to cigarette smoking cessation. It has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. Growth in the electronic cigarette, vapor product and smokeless tobacco product markets may have an adverse effect on the traditional cigarette market. If consumers use such products in lieu of traditional cigarettes containing nicotine or to quit smoking, it could reduce the size of the cigarette market. Furthermore, while alternative cigarette products continue to be deemed not to constitute "cigarettes" under the MSA and gain market share of the domestic cigarette market to the detriment of traditional cigarettes, payments under the MSA may decrease, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—E-Cigarettes and Vapor Products" and "—Smokeless Tobacco Products."

U.S. Tobacco Companies are Subject to Significant Limitations on Advertising and Marketing Cigarettes that Could Negatively Impact Sales Volume

Television and radio advertisements of tobacco products have been prohibited since 1971. U.S. tobacco companies generally cannot use billboard advertising, cartoon characters, sponsorship of concerts, non-tobacco merchandise bearing brand names and various other advertising and marketing techniques. In addition, the MSA prohibits the targeting of youth in advertising, promotion or marketing of tobacco products. Accordingly, the tobacco companies have determined not to advertise cigarettes in magazines with large readership among people under the age of 18. Under the FSPTCA, which grants authority over the regulation of tobacco products to the FDA, the FDA has issued rules restricting access and marketing of cigarettes and smokeless tobacco products to youth, and announced its plans to propose a new rule in the future for the imposition of larger, graphic health warnings on cigarette packaging and advertising, as discussed herein. In addition, many states, cities and counties have enacted legislation or regulations further restricting tobacco advertising, marketing and sales promotions, and others may do so in the future. Additional restrictions may be imposed or agreed to in the future. These limitations significantly impair the ability of tobacco product manufacturers to launch new premium brands. Moreover, these limitations may make it difficult for PMs to maintain sales volume of cigarettes in the U.S., which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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

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

Certain stores have ceased the sale of tobacco products. The retail chain store Target stopped selling tobacco products in 1996. In September 2014 the national pharmacy chain CVS reportedly stopped selling all cigarettes and other tobacco products in all its stores (following a February 2014 announcement), citing that such sales were inconsistent with its mission. A group of U.S. Attorneys General have pressured large retail stores with pharmacies to take similar action, and in April 2014 several members of Congress called on these retailers to stop selling cigarettes and other items containing tobacco. Costco has also reportedly reduced the number of locations that sell cigarettes because of slowing demand, according to news reports in March 2016. Continued curtailment in the distribution of cigarettes could negatively impact sales volume, which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

Smoking Cessation Products May Reduce Cigarette Sales Volumes and Adversely Affect Payments Under the MSA

Large pharmaceutical companies have developed and increasingly expanded their marketing of smoking cessation products. Companies such as GlaxoSmithKline, Johnson & Johnson, Novartis and Pfizer are very well capitalized public companies that have entered this market and have the capability to fund significant investments in research and development and marketing of these products. Smoking cessation products can be obtained both in prescription and over-the-counter forms. From Nicorette gum in 1984, to nicotine patches, nicotine inhalers and tablets, as well as other non-pharmaceutical smoking cessation products, this market has evolved into a $1 billion business in the U.S., according to some estimates. Studies have shown that these programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. Certain health insurance policies, including Medicaid and Medicare, cover various forms of smoking cessation treatments, making smoking cessation treatments more affordable for covered smokers. To the extent that existing smoking cessation products, new products or products used in combination become more effective and more widely available, or that more smokers use these products, sales volumes of cigarettes in the U.S. may decline, which could lead to reductions of payments under the MSA and could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Smoking Cessation Products".

The U.S. Cigarette Industry is Subject to Significant Law, Regulation and Other Requirements That Could Adversely Affect the Businesses, Results of Operations or Financial Condition of Tobacco Product Manufacturers

The consumption of cigarettes in the U.S., and therefore the amounts payable under the MSA and the Pledged TSRs available to TSASC to pay debt service on the Series 2017 Bonds, could be materially adversely affected by new or future legal requirements imposed by legislative or regulatory initiatives, including but not limited to those relating to health care reform, climate change and environmental matters.

The Availability of Counterfeit Cigarettes Could Adversely Affect Payments by the PMs Under the MSA

Sales of counterfeit cigarettes in the U.S. could adversely impact sales by the PMs of the brands that are counterfeited and potentially damage the value and reputation of those brands. Smokers who mistake counterfeit cigarettes for cigarettes of the PMs may attribute quality and taste deficiencies in the counterfeit product to the actual branded products brands and discontinue purchasing such brands. Most significantly, the availability of counterfeit cigarettes together with substantial increases in excise taxes and other potential price increases of branded products could result in increased demand for counterfeit products that could have a material adverse effect on the sales volume of the PMs, resulting in lower payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

General Economic Conditions May Materially Adversely Affect Consumption of Cigarettes and the Ability of the PMs to Continue to Operate, Reducing Their Sales of Cigarettes and Payments under the MSA

The volume of cigarette sales in the U.S. is adversely affected by general economic downturns as smokers tend to reduce expenditures on cigarettes, especially premium brands, in times of economic hardship. In addition, consumers may become more price-sensitive, which may result in some consumers switching to lower priced, deep discount NPM brands, or counterfeit brands, or travelling longer distances to purchase untaxed NPM cigarettes on Native American reservations. Reductions in consumption or changes in consumption habits to NPM cigarettes could lead to reductions of payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

The ability of the PMs to continue their operations selling cigarettes in the U.S. generally is dependent on the health of the overall economy and their ability to access the capital markets on favorable terms. To the extent that overall economic conditions or constrained capital access materially adversely impacts their operations, the PMs may sell fewer cigarettes, potentially resulting in reduced payments under the MSA and reduced Pledged TSRs available to TSASC to pay debt service on the Series 2017 Bonds.

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

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

All of the judgments rendered to date on the merits have rejected challenges to the MSA, Qualifying Statutes and Complementary Legislation presented in the cases. Courts rendering those decisions include the U.S. Courts of Appeals for the Second Circuit in *Freedom Holdings v. Cuomo* and *Grand River Enterprises Six Nations, Ltd. v. King*; the Tenth Circuit in *KT & G Corp. v. Edmondson*, and *Hise v. Philip Morris Inc.*; the Eighth Circuit in *Grand River Enterprises v. Beebe*; the Third Circuit in *Mariana v. Fisher*, and *A.D. Bedell Wholesale Co. v. Philip Morris Inc.*; the Fourth Circuit in *Star Sci., Inc. v. Beales*; the Fifth Circuit in *Xcaliber Int'l Ltd. v. Caldwell* and *S&M Brands v. Caldwell*; the Sixth Circuit in *S&M Brands v. Cooper, S&M Brands, Inc. v. Summers*, *Tritent Inter'l Corp. v. Commonwealth of Kentucky* and *VIBO Corporation, Inc. d/b/a/ General Tobacco v. Conway, et al.*; the Ninth Circuit, in *Sanders v. Brown*; and multiple lower courts. In addition, in January 2011, an international arbitration tribunal rejected claims brought against the United States challenging MSA-related legislation in various states under NAFTA.

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

The MSA, Qualifying Statutes and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State, the City and TSASC that the MSA, Qualifying Statutes or related state legislation is void or unenforceable could have a material adverse effect on the payments by the PMs under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. Although a determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have a material adverse effect on payments to be made under the MSA and Pledged TSRs available to TSASC if an NPM were to gain market share in the future and there occurred an impact on the market share of the PMs under the MSA. A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, and thereby potentially increase their market share at the expense of the PMs. A determination that the State's Complementary Legislation is unenforceable would not constitute a breach of the MSA or affect the enforceability of the State's Qualifying Statute; such a determination could, however, make enforcement of the State's Qualifying Statute against NPMs more difficult for the State. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT". For a description of the opinion of Transaction Counsel addressing such matters, see "LEGAL CONSIDERATIONS—MSA and Qualifying Statute Enforceability".

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

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging various theories of recovery including that smoking has been injurious to their health, by non-smokers alleging harm from environmental tobacco smoke ("**ETS**"), also known as "secondhand smoke", and by the federal, state and local governments seeking recovery of expenditures relating to the adverse effects on the public health caused by smoking. The MSA was the result of such litigation. If additional litigation against the PMs is successful on a significant level, the ability of the PMs to continue to operate their businesses and make payments under the MSA may be materially adversely affected, which in turn could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" for more information regarding the litigation described below.

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

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

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

financial condition of the PMs. Adverse decisions in litigation against the tobacco companies could have an adverse impact on the industry overall.

Any of the foregoing results could potentially lower the volume of cigarette sales and thus materially adversely affect the amounts of payments under the MSA and the Pledged TSRs available to TSASC to pay debt service on the Series 2017 Bonds. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation".

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

The case of *Engle v. R.J. Reynolds Tobacco Co., et al.* (Circuit Court, Dade County, Florida, filed May 5, 1994) was certified in 1996 as a class action on behalf of Florida residents, and survivors of Florida residents, who were injured or died from medical conditions allegedly caused by addiction to smoking and a multi-phase trial resulted in verdicts in favor of the class. During a three-phase trial, a Florida jury awarded compensatory damages to three individuals and approximately $145 billion in punitive damages to the certified class. In 2006, although the Florida Supreme Court vacated the punitive damages award and determined that the case could not proceed further as a class action, it permitted members of the *Engle* class to file individual claims, including claims for punitive damages, and held that these individual plaintiffs are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial, including that smoking cigarettes causes a number of diseases; that cigarettes are addictive or dependence-producing; and that the defendants were negligent, breached express and implied warranties, placed cigarettes on the market that were defective and unreasonably dangerous, and concealed or conspired to conceal the risks of smoking. In the wake of the Florida Supreme Court ruling, thousands of individuals filed separate lawsuits seeking to benefit from the *Engle* findings. The PMs are currently defendants in approximately 3,000 cases (involving approximately 4,000 plaintiffs) pending in various state and federal courts in Florida that were filed by members of the Engle class (the "***Engle* Progeny Cases**") (although most federal cases were settled, as discussed herein).

At the beginning of the *Engle* Progeny Cases litigation, a central issue was the proper use of the preserved *Engle* findings. The tobacco manufacturers had argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment) was a violation of federal due process, but in 2013, both the Florida Supreme Court (in the *Douglas* case) and the Eleventh Circuit (in the *Duke* and *Walker* cases) rejected that argument, and the U.S. Supreme Court denied the tobacco manufacturers' petitions for writ of certiorari in all of those cases. As discussed herein, the Eleventh Circuit recently heard argument on this issue again. Other issues with respect to the *Engle* Progeny Cases were decided or remain pending on appeal. It is not possible to predict the final outcomes of any of the *Engle* Progeny Cases, but such outcomes may materially adversely affect the operations of the defendants and thus payments under the MSA and the Pledged TSRs available to TSASC to pay debt service on the Series 2017 Bonds. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation–*Overview-Engle* Progeny Cases".

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

In December 2008, the U.S. Supreme Court in a purported "lights" class action, *Good v. Altria Group, Inc.*, issued a decision that neither the Federal Cigarette Labeling and Advertising Act nor the Federal Trade Commission's ("**FTC**") regulation of cigarettes' tar and nicotine disclosures preempts (or bars) some of plaintiffs' claims. The decision also more broadly addresses the scope of preemption based on the Federal Cigarette Labeling and Advertising Act, and could significantly limit cigarette manufacturers' arguments that certain of plaintiffs' other claims in smoking and health litigation, including claims based on the alleged concealment of information with respect to the hazards of smoking, are preempted. In addition, the Supreme Court's ruling could encourage litigation against cigarette manufacturers regarding the sale of cigarettes labeled as "lights" or "low tar", and it may limit cigarette manufacturers' ability to defend such claims with regard to the use of these descriptors prior to the FDA's ban thereof in June 2010. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, there are approximately 9 such "lights" class actions pending in various courts as of October 24, 2016. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation–*Class Action Cas*es."

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

Except for the impact of the State Settlement Agreements (defined below) on an annual basis when calculated, the PMs have stated that (i) their management has concluded that it is not probable that a loss has been incurred in any material pending litigation against them, (ii) their management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome of any material pending litigation due to the many variables, uncertainties and complexities, and (iii) accordingly, their management has not provided any amounts in their consolidated financial statements for possible losses related to material pending litigation. It is possible that their results of operations, cash flows and financial positions could be materially adversely affected by an unfavorable outcome of certain pending or future litigation, potentially leading to cessation of operations or insolvency or bankruptcy of one or more PMs, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in bankruptcy, insolvency or a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption. In addition, the financial condition of any or all of the PM defendants could be adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could materially impair the affected PM's ability to make payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS".

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

In 1998, the OPMs entered into the MSA with 46 states and 6 other U.S. jurisdictions to settle asserted and unasserted health care cost recovery and other claims. Certain U.S. tobacco product manufacturers had previously settled similar claims brought by Mississippi, Florida, Texas and Minnesota (the "**Previously Settled State Settlements**" and, together with the MSA, are referred to as the "**State Settlement Agreements**").

Under the State Settlement Agreements, the PMs are obligated to pay billions of dollars each year. Annual payments under the State Settlement Agreements are required to be paid in perpetuity and are based, among other things, on domestic market share and unit volume of domestic shipments. With respect to the MSA, payments are based on data from the year preceding the year in which payment is due, and, with respect to the Previously Settled State Settlements, payments are based on data from the year in which payment is due. If the volume of cigarette sales by the PMs were materially reduced, these payment obligations could materially adversely affect the financial condition of the PMs and potentially the ability of PMs to make payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT".

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

In August 2006, a final judgment and remedial order was entered in *United States of America v. Philip Morris USA, Inc., et al.* (U.S. District Court, District of Columbia, filed September 22, 1999) (the "**DOJ Case**") and in June 2010 the U.S. Supreme Court denied all petitions for review of the case. The district court based its final judgment and remedial order on the government's only remaining claims, which were based on the tobacco industry

defendants' alleged violations of RICO. Although the verdict did not award monetary damages to the plaintiff U.S. government, the final judgment and remedial order imposed a number of requirements on the defendants. Such requirements include, but are not limited to, corrective statements by defendants related to the health effects of smoking. The remedial order placed certain prohibitions on the manner in which defendants market their cigarette products and enjoined any use of "lights" or similar product descriptors. On July 27, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's denial in June 2011 of the defendants' motion to vacate. On November 27, 2012, the district court released the text of the corrective statements that the defendants must put on their websites. In January 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 ruling on the text of the corrective statements, claiming a violation of free speech rights. On June 2, 2014, the U.S. District Court for the District of Columbia approved a joint motion by the U.S. government and the defendant tobacco companies, pursuant to which, for specified time periods following the date when all appeals are exhausted, corrective statements would be disseminated in newspapers (print and online), on television, on the tobacco companies' websites, and on "onserts" affixed to cigarette packs. On February 8, 2016, the district court issued an order on the content of the corrective statements, and in April 2016, the defendants filed a notice of appeal to the U.S. Court of Appeals on the content of the corrective statements. It is possible that the order, including the prohibitions on the use of the descriptors relating to low tar cigarettes and the stark text required in the corrective statements, will negatively affect the PMs' sales of and profits from cigarettes, as well as result in significant compliance costs, which could materially adversely affect their payments under the MSA, which in turn could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Civil Litigation."

Risks Relating to the IHS Global Reports

The Pledged TSRs projections developed using the Pledged TSRs Projection Methodology and Assumptions (as defined herein) and described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" are based in part upon (a) the tobacco consumption forecast contained in the IHS Global Consumption Report and (b) the Tribal NPM Packs sales forecast contained in the IHS Global Tribal Sales Report. No assurance can be given that actual future consumption will be consistent with that which is projected in the IHS Global Consumption Report. Prior IHS Global consumption reports delivered to TSASC by IHS Global have projected consumption to be more than that which actually occurred. Similarly, no assurance can be given that future Tribal NPM Packs sales will be consistent with that which is projected in the IHS Global Tribal Sales Report, which is one of the first reports relating to Tribal NPM Packs sales prepared by IHS Global. Under the NY NPM Settlement, the determination of estimated Tribal NPM Packs sales that will be used in calculating the Tribal NPM Packs Credit will be made every two years by a third-party Investigator selected as described in the NY NPM Settlement. No assurance can be given that the methodology used and the data relied upon by the Investigator in its bi-annual estimate of Tribal NPM Pack sales will be consistent with the methodology and data used by IHS Global in preparing its forecast, nor can there be any assurance as to the size of future Variable Tribal NPM Packs Credits under the NY NPM Settlement. See APPENDIX A—"IHS GLOBAL REPORTS".

Other Risks Relating to the MSA and Related Statutes

Severability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any non-severable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. If, however, any OPM does not agree to the substitute terms, the MSA terminates in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA or otherwise could be made according to or subject to different terms and conditions, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full. See "—If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments under the MSA Might be Suspended or Terminated" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Severability".

Amendments, Waivers and Termination

As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. Neither the City nor TSASC is a party to the MSA; accordingly, the City and TSASC do not have any right to challenge any such amendment, waiver or termination. While the economic interests of the State and the holders of the Series 2017 Bonds are expected to be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on TSASC and its ability to pay debt service on the Series 2017 Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Amendments and Waivers".

Reliance on State Enforcement of the MSA and Related Documents

The State has not conveyed and cannot convey to the City or TSASC, or the holders of any Series 2017 Bonds, any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled under the Decree to a substantial portion of the State's allocable share of each Annual Payment under the MSA, no assurance can be given that the State will enforce any particular provision of the MSA. Failure to do so may have a material adverse effect on the Bondholders. Only the State may enforce the payment provisions of the Decree against the PMs. The NY NPM Settlement states that, except with respect certain releases that extend to agents and officers of the State and the signatory PMs, no portion of the NY NPM Settlement shall provide any rights to, or be enforceable by, any person or entity other than the State and the signatory PMs.

TSASC does not have rights to enforce State laws relating to the sale of cigarettes on Native American reservations or the collection of State cigarette excise on such sales. The enforcement of such laws are among the factors affecting the level of Tribal NPM Packs sales in the State and the size of future Variable Tribal NPM Packs Credits under the NY NPM Settlement which reduce Annual Payments under the MSA and therefore reduce Pledged TSRs available to TSASC to pay debt service on the Series 2017 Bonds. See "NY NPM SETTLEMENT" and "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES."

Amendment to the State's Qualifying Statute

The MSA provides that if a state adopts the Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. Under the terms of the NY NPM Settlement, the NPM Adjustment is no longer applicable to the State, except in very limited circumstances. However, under the MSA, the PMs would be entitled to a material credit for each pack of NPM cigarettes on which State cigarette tax was paid, but an escrow deposit required under the State Qualifying Statute was not made because the Qualifying Statute had been repealed or amended. No assurance can be provided the State will not repeal or amend its Qualifying Statute, or that any amendment would not cause the State's Qualifying Statute as so amended to not continue to constitute a Qualifying Statute. Should any amendment to the State's Qualifying Statute cause it to no longer require the escrow currently required, or should such Qualifying Statute be repealed, then the State would no longer be entitled to any protection from the NPM Adjustment. See "LEGAL CONSIDERATIONS—MSA and Qualifying Statute Enforceability."

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

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

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the City, TSASC, the Indenture Trustee or the Bondholders or the beneficial owners of the Series 2017 Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further

payments of TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM could seek court approval to reject the MSA and stop making payments under it.

Furthermore, payments previously made to the holders or beneficial owners of the Series 2017 Bonds could be avoided as preferential payments, so that such holders or beneficial owners would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the City, TSASC, the Indenture Trustee or the holders and beneficial owners of the Series 2017 Bonds. Finally, while there are provisions of the MSA purporting to deal with the situation when a PM goes into bankruptcy (including provisions regarding the termination of that PM's obligations) (see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Termination of MSA"), such provisions may be unenforceable. NAAG has stated that it actively monitors any bankruptcy related activity of the PMs with the goals of preventing the debtors from using bankruptcy law to avoid their MSA payment obligations to the Settling States and ensuring that Settling States can continue to perform their regulatory duties despite the bankruptcy filing, but there can be no assurance that the actions of NAAG will be successful. There may be other possible effects of a bankruptcy of a PM that could result in delays and/or reductions in, or elimination of, TSRs. Regardless of any specific adverse determination in a PM bankruptcy proceeding, the fact of a PM bankruptcy proceeding could have a material adverse effect on the timing of receipt, amount and value of the Pledged TSRs.

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

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

A PM could discontinue making required payments under the MSA for any reason. Any attempts to enforce payments under the MSA from a PM in breach could be costly and time consuming as well as likely to include litigation. For example, VIBO Corporation, Inc., d/b/a General Tobacco ("**General Tobacco**") ceased production of cigarettes in 2010 and has defaulted upon certain of its MSA payments. General Tobacco has stated that it will be unable to make any back payments it owes under the MSA. Two Settling States brought suit on behalf of all of the Settling States seeking full payment by General Tobacco of its MSA obligations. The ability of the Settling States to enforce and collect such payments in instances such as this is limited by the ability of the defaulting PM to meet its obligations and may be costly. Failure by other PMs to make payments could be coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA, which could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

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

Bekenton to continue selling cigarettes in Iowa. The court found that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case.

Limited Resources of TSASC; Series 2017 Bonds Are Not a Debt of the City or State

The Series 2017 Bonds are limited obligations of TSASC and are payable only from the Collateral. In the event that the assets of TSASC have been exhausted, no amounts will thereafter be paid on the Series 2017 Bonds. The Bonds are not obligations of the City or the State, neither the City nor the State is liable thereon, and no recourse may be had to either for payment of amounts owing on the Series 2017 Bonds. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, the revenues nor the taxing power of the State or the City is, or shall be deemed to be, pledged to the payment of any of the Series 2017 Bonds. TSASC has no taxing power. See "SECURITY FOR THE BONDS".

Bankruptcy of the City

Because the City is a governmental entity, it cannot be the subject of any involuntary bankruptcy case under the Bankruptcy Code, and it can become a debtor only in a voluntary case. The City is authorized by statute to file a voluntary petition for bankruptcy under the Bankruptcy Code. The City and TSASC, at the time of the execution of the TSR Purchase Agreement, intended and structured the transfer of the Tobacco Assets to TSASC as an absolute sale and not as the grant of a security interest in the Tobacco Assets to secure a borrowing of the City. If the City were to become a debtor in a bankruptcy case, and a party in interest (including the City itself) were to take the position that the transfer of the Tobacco Assets to TSASC should be recharacterized as the grant of a security interest in the Tobacco Assets, and a court were to adopt such position, then delays or reductions in payments or a loss of future payments on the Series 2017 Bonds could result. Losses suffered by Bondholders could be even more severe because, under State law, the City does not have the authority to borrow money secured by the Tobacco Assets, and thus, if the transfer from the City to TSASC is recharacterized as a borrowing, the transfer of the Tobacco Assets to TSASC may be void. Because TSASC does not have any other funds with which to make payments on the Series 2017 Bonds, the Bondholders could suffer a loss of their entire investment in such circumstances. See "LEGAL CONSIDERATIONS—Recharacterization of the Transfer of Tobacco Assets Could Void Transfer".

The City and TSASC have taken steps to minimize the risk that in the event the City were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the City be substantively consolidated with those of TSASC. TSASC is a separate, special purpose not-for-profit corporation, the organizational documents of which provide that it shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors (although this provision may not be enforceable). Nonetheless, no assurance can be given that if the City were to become a debtor in a bankruptcy case, a party in interest (including the City itself) would not take the position that, and a court would not order that, the assets and liabilities of TSASC be substantively consolidated with those of the City, thus resulting in delays and/or reductions in payments or a loss of future payments on the Series 2017 Bonds.

Actions could be taken in a bankruptcy of the City which would adversely affect the exclusion of interest on the Series 2017 Bonds from gross income for federal income tax purposes. There may be other possible effects of a bankruptcy of the City that could result in delays and/or reductions in payments or a loss of future payments to the holders of the Series 2017 Bonds.

Regardless of any specific adverse determinations in a City bankruptcy proceeding, the fact of a City bankruptcy proceeding could have a material adverse effect on the Series 2017 Bonds. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered by Transaction Counsel with respect to City bankruptcy matters, see "LEGAL CONSIDERATIONS—Bankruptcy of the City".

Limited Remedies

The Indenture Trustee is limited under the terms of the TSR Purchase Agreement to enforcing the terms of such agreement and to receiving the Pledged TSRs and applying them in accordance with the Indenture. If an Event of Default occurs, the Indenture Trustee cannot sell or foreclose on the Pledged TSRs or its rights under the TSR

Purchase Agreement. Neither the City nor TSASC is a party to the MSA and neither has made any representation or warranty that the MSA is enforceable. Remedies under the TSR Purchase Agreement do not include the repurchase by the City of the Tobacco Assets under any circumstances, including unenforceability of the MSA, the Qualifying Statute or breach of any representation or warranty. The remedies of the Series 2017 Bondholders are no greater than those afforded to the Indenture Trustee.

Limited Liquidity; Price Volatility

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

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

In recent years, rating agencies, including S&P Global Ratings (the rating agency rating the rated Series 2017 Bonds) ("**S&P**" or the "**Rating Agency**"), have revised their assumptions regarding their ratings of unenhanced tobacco settlement bonds on account of the continuing decline in MSA payments resulting from cigarette volume decline, withholdings by PMs of MSA payments, and disputes and settlements relating to MSA payments.

Most recently, in June 2016, Fitch Ratings withdrew its outstanding structured finance ratings on all of its rated U.S. tobacco asset-backed securities. In its May 2016 announcement of its intention to withdraw the ratings, Fitch Ratings said the primary reason for the withdrawal was that individual, custom modifications (by several participants) to material calculations originally part of the MSA have eroded Fitch Ratings' confidence that ratings "can be consistently maintained, as insufficient information exists to predict the likelihood and effect of future modifications or that insufficient information will exist to support new, material variables included in them." Fitch Ratings stated that more recent settlement agreements, including the NY NPM Settlement, related to disputed payments connected to the NPM Adjustment under the MSA "have eroded Fitch's confidence in the predictability of the calculation of MSA payments going forward." Fitch Ratings also stated in its announcement that the NY NPM Settlement "introduces a new variable, a calculation related to Tribal Sales, which is based on estimates initially and its past and future volatility is unknown."

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

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

Uncertainty as to Timing of Turbo Redemptions

No assurance can be given as to the timing of amortization of the Series 2017B Subordinate Bonds. A certain level of payments due under the MSA has been forecast based on various assumptions, including among

others, levels of domestic cigarette consumption and sales of Tribal NPM Packs as set forth in the IHS Global Consumption Report and IHS Global Tribal Sales Report, respectively. These assumptions, which were used to provide expectations of Turbo Redemptions of the Series 2017B Subordinate Bonds from Turbo Available Collections, are discussed in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". No assurance can be given that these assumptions will be realized. Actual results could and likely will vary from such assumptions. Such variance could be material. Any material reduction in Pledged TSRs or earnings on the Pledged Accounts would impair the Turbo Available Collections available to make Turbo Redemptions of the Series 2017B Subordinate Bonds and extend the average lives of the Series 2017B Subordinate Bonds. On the other hand, material increases in Pledged TSRs would generate more Turbo Available Collections to make Turbo Redemptions and shorten the average lives of the Series 2017B Subordinate Bonds. In addition, future increases in the rate of inflation above 3% per annum could, in the absence of other factors, materially shorten the average lives of the Series 2017B Subordinate Bonds.

The ratings of the Series 2017B Subordinate Bonds do not address projected Turbo Redemptions. Owners of the Series 2017B Subordinate Bonds bear the reinvestment risk from faster than expected amortization as well as the extension risk from slower than expected amortization.

Risk Related to Lump Sum Payments

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

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could adversely affect the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full, and could have an adverse effect on the liquidity and/or market value of the Series 2017 Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Pledged TSRs to be reduced or eliminated. References in the discussion to various opinions are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions. See also "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES—Legal Considerations Relating to Collection of State Cigarette Tax on Tribal Sales."

Bankruptcy of a PM

The enforceability of the rights and remedies of the State (and thus the Bondholders) and of the obligations of a PM under the MSA (on which the debt service payments of TSASC depend) are subject to the Bankruptcy Code and to other applicable insolvency, moratorium or similar laws relating to or affecting the enforcement of creditors' rights generally. See "RISK FACTORS—Bankruptcy of a PM May Delay, Reduce or Eliminate Payments Under the MSA" for risks relating to the automatic stay provisions of the Bankruptcy Code, "executory contracts," preferential payments, alteration of the terms of payment obligations, and other factors.

Transaction Counsel will render an opinion to the Rating Agency 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 after the Closing Date 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, but Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing federal 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 and/or reductions in payments on, or other losses with respect to, the

Series 2017 Bonds. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM could reject the MSA and stop making payments under it.

Recharacterization of Transfer of Tobacco Assets Could Void Transfer

As a matter of State law, the City does not have the authority to borrow money secured by the Tobacco Assets. Thus, if the transfer from the City to TSASC is not a sale of the Tobacco Assets, but is instead determined to be a borrowing by the City secured by the Tobacco Assets, the transfer of the Tobacco Assets to TSASC may be void. The City and TSASC took steps to structure the transfer of the Tobacco Assets to TSASC as an absolute sale and not as the grant of a security interest in the Tobacco Assets to secure a borrowing by the City. Nonetheless, no assurance can be given that a court would not find that the transfer of the Tobacco Assets to TSASC is a secured borrowing. Because TSASC does not have any other material funds with which to make payments on the Series 2017 Bonds, if there were such a finding, the Bondholders and the beneficial owners of the Series 2017 Bonds could suffer a loss of their entire investment.

Bankruptcy of the City

The City is authorized by statute to file a voluntary petition for bankruptcy under the Bankruptcy Code. See "RISK FACTORS—Bankruptcy of the City" and "LEGAL CONSIDERATIONS—Recharacterization of Transfer of Tobacco Assets Could Void Transfer" for a description of the risks relating to a recharacterization of the transfer of the Tobacco Assets to TSASC as the grant of a security interest (and not an absolute sale), and risks relating to substantive consolidation of the assets and liabilities of TSASC with those of the City, among other factors.

Transaction Counsel will render an opinion to the Rating Agency that, subject to all the assumptions, qualifications, and limitations set forth therein, if the City were to become the debtor in a case under the Bankruptcy Code after the Closing Date, 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 a transfer of the right to be paid the Tobacco Assets by the City to TSASC in the form and manner set forth in the TSR Purchase Agreement would constitute an absolute sale of the right to be paid the Tobacco Assets, rather than a borrowing by the City secured by the right to be paid the Tobacco Assets, so that the right to be paid the Tobacco Assets would not be property of the estate of City under Section 902(1) 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 Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing federal 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 court would not hold that the transfer of the right to be paid the Tobacco Assets to TSASC should be recharacterized as the grant of a security interest in the right to be paid the Tobacco Assets, thus resulting in delays and/or reductions in payments on, or other losses with respect to, the Series 2017 Bonds.

Transaction Counsel will also render an opinion to the Rating Agency that, subject to all the assumptions, qualifications, and limitations set forth therein, if the City were to become the debtor in a case under the Bankruptcy Code after the Closing Date, 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 not order, over the objection of the parties to the transactions contemplated by the transaction documents, the substantive consolidation of the assets and liabilities of TSASC with those of the City. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing federal 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 if the City were to become a debtor in a bankruptcy case, a court would not order that the assets and liabilities of TSASC be consolidated with those of the City, thus resulting in delays and/or reductions in payments on, or other losses with respect to the Series 2017 Bonds.

MSA and Qualifying Statute Enforceability

Certain parties have filed lawsuits against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA, Qualifying Statutes and Complementary Legislation violate and are void or unenforceable under certain provisions of law. See "RISK FACTORS—If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments under the MSA Might be Suspended or Terminated".

Transaction Counsel will render an opinion on the Closing Date to the Rating Agency that, subject to all the assumptions, qualifications, and limitations set forth therein, if the matter were properly briefed and presented to a court, the court, applying existing legal principles to the facts and exercising reasonable judgment after full consideration of all relevant factors, would hold that (a) the MSA is a valid and enforceable agreement and (b) the New York Model Statute is valid, enforceable, and constitutional in all material respects. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. Transaction Counsel will assume, among other things, that the NY NPM Settlement and all amendments to the New York Model Statute after its enactment on November 27, 1999, are valid, binding, and enforceable in accordance with their terms, constitutional, and do not conflict with, and are permitted by, the MSA, and that the New York Model Statute, both before and after the amendments thereto after its enactment on November 27, 1999, is a "Qualifying Statute" within the meaning of the MSA. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, the matter is not free from doubt, and there can be no assurance that a court applying existing legal principles would not hold otherwise. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not valid or enforceable, or that the New York Model Statute is not valid, enforceable, or constitutional, thus resulting in delays and/or reductions in, or elimination of, payments on the Series 2017 Bonds. This opinion is also subject to the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law, and the possible unavailability of any specific remedy.

The MSA provides that it can be amended only with the consent of the parties affected by the amendment. No assurance can be given that the NY NPM Settlement does not constitute an amendment of the MSA or that the NY NPM Settlement does not have an effect on parties that are not signatories to the NY NPM Settlement. If it were to be determined that the NY NPM Settlement does have an effect on parties that are not signatories, then all or part of the NY NPM Settlement may be unenforceable, which could have a material adverse effect on TSASC and its ability to pay debt service on the Series 2017 Bonds.

Transaction Counsel will not render an opinion regarding the NY NPM Settlement.

Limitations on Certain Opinions

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

Enforcement of Rights to Pledged TSRs

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

Contractual Remedies

Under New York law, settlements are treated as contracts and may be enforced according to their terms. The Decree, coupled with the MSA, is a court-approved settlement of lawsuits that establishes the City's right to receive the TSRs and to bring suit against the State to enforce its right to receive the TSRs. The TSR Purchase Agreement obligates the City to take all necessary action to protect TSASC's interest in the TSRs. Thus, if the State violates the provisions of the Decree so as to impair the City's right to the TSRs, the Indenture Trustee, as assignee of TSASC's rights under the TSR Purchase Agreement, could seek to compel the City to enforce its payment rights under the Decree. As interested parties, TSASC on its own behalf and the Indenture Trustee on behalf of the Bondholders could also seek to enforce the City's rights under the Decree, although, as third parties to the Decree, their rights to do so are uncertain.

Fiduciary Relationship Remedies

As the lead New York plaintiff in the class action lawsuit underlying the Decree, the State stands in a relationship of faith and trust with the other class members, including the City. Among other fiduciary obligations, the State as the lead plaintiff bears a duty to protect faithfully the settlement interest of the other class members. Consequently, action by the State, either unilaterally or by agreement with the OPMs, to amend the Decree, or otherwise impair the City's rights to the TSRs without its consent, could constitute a breach of the State's fiduciary duties.

Constitutional Claims

Although the State has not contracted directly with the Bondholders, it has entered into the Decree allocating its share of the benefits of the MSA among itself, the City and the other counties in the State. The Pledged TSRs and money derived therefrom are the primary source of payment for the Series 2017 Bonds.

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

Constitutional Rights

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

No Assurance as to the Outcome of Litigation or Arbitration Proceedings

With respect to all matters of litigation mentioned above that have been brought and may in the future be brought against the PMs, or involving the enforceability or constitutionality of the MSA, the NY NPM Settlement, and/or the State's related legislation, Qualifying Statute or the enforcement of the right to the Pledged TSRs or otherwise filed in connection with the tobacco industry or involving arbitration under the MSA or the NY NPM Settlement, the outcome of such litigation or arbitration proceedings, in general, cannot be predicted with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and arbitration panels and (ii) the courts or panels, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation or arbitration, and any adverse outcome could materially adversely affect the amount and/or timing of the Pledged TSRs and the ability of TSASC to pay debt service on all or a portion of the Series 2017 Bonds on a timely basis or in full.

THE SERIES 2017 BONDS

The following summary describes certain terms of the Series 2017 Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2017 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2017 Bonds will initially be represented by one or more bond certificates registered in the name of The Depository Trust Company, New York, New York ("**DTC**"), or its nominee. DTC will act as securities depository for the Series 2017 Bonds. The Series 2017 Bonds other than the Series 2017B Subordinate Bonds maturing on June 1, 2052* will be available for purchase in denominations of $5,000 or any integral multiple thereof in book-entry form only. The Series 2017B Subordinate Bonds maturing on June 1, 2052* will be available for purchase in denominations of $100,000 and integral multiples of $5,000 in excess thereof in book-entry form only. Except under the limited circumstances described herein, no beneficial owner of the Series 2017 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Bonds. See APPENDIX F—"BOOK-ENTRY ONLY SYSTEM" herein.

For each Distribution Date, payments will be made to registered owners of the Series 2017 Bonds (the "**Owners**") as of the 15th day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs (the "**Record Date**"). The Indenture Trustee and TSASC may establish special record dates for the determination of the Owners for various purposes of the Indenture, including giving consent or direction to the Indenture Trustee.

Payments of Interest

Interest on the principal balance of the Series 2017 Bonds will be payable on each June 1 and December 1, commencing June 1, 2017 (each, a "**Distribution Date**"). Interest will accrue from and including the Closing Date. Interest on the Series 2017 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Senior Liquidity Reserve Account is available to pay interest on the Series 2017A Senior Bonds when due. The Subordinate Liquidity Reserve Account is available to pay interest on the Series 2017B Subordinate Bonds when due. Failure to pay the full amount of interest payable on any Distribution Date is an Event of Default under the Indenture.

If on any Distribution Date there are insufficient funds to pay all interest then due on the Bonds, available amounts will be allocated as described in "SECURITY FOR THE BONDS—Application of Collections—Payment Defaults".

* Preliminary, subject to change.

Payments of Principal

Principal on the Series 2017 Bonds will be payable on the respective scheduled Maturity Dates as set forth on the inside cover of this Offering Circular, subject to special mandatory and optional redemption as provided herein. So long as no Event of Default has occurred, all payments of principal made on the Series 2017B Subordinate Bonds from Collections will be credited against scheduled Maturity Dates in chronological order. The Senior Liquidity Reserve Account is available to pay the principal of the Series 2017A Senior Bonds on their respective scheduled Maturity Dates and Mandatory Sinking Fund Installment payment dates. The Subordinate Liquidity Reserve Account is available to pay the principal of the Series 2017B Subordinate Bonds on their respective scheduled Maturity Dates. Failure to pay the principal of a Series 2017 Bond on its scheduled Maturity Date or Mandatory Sinking Fund Installment payment date will constitute an Event of Default under the Indenture, in which case all future payments will be made as described in "SECURITY FOR THE BONDS—Application of Collections—Payment Defaults". Failure to pay Turbo Redemptions on the Series 2017B Subordinate Bonds will not constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections.

If less than all of the Series 2017 Bonds of any maturity or Mandatory Sinking Fund Installment, as applicable, are to be redeemed, the Owners of the Series 2017 Bonds of such maturity or Mandatory Sinking Fund Installment will be paid as described under the heading "—Partial Redemptions" below.

Redemption Provisions*

Optional Redemption

Optional Redemption of Series 2017A Senior Bonds

The Series 2017A Senior Bonds are subject to optional redemption (from any source other than moneys in the Pledged Accounts) at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date, in whole or in part, in applicable authorized denominations, on any date on or after June 1, ____, from any maturity selected by TSASC in its discretion and on such basis as the Indenture Trustee shall deem fair and appropriate, including by lot, within a maturity.

Optional Redemption of Series 2017B Subordinate Bonds

The Series 2017B Subordinate Bonds are subject to optional redemption (from any source other than moneys in the Pledged Accounts) at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date: (1) in whole or in part, in applicable authorized denominations, at any time, but only in an amount that may not exceed the cumulative amount of the Turbo Redemptions that were projected (using the forecast contained in the IHS Global Consumption Report and the base case forecast contained in the IHS Global Tribal Sales Report) to be paid, as set forth in "TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE—Projected Series 2017 Debt Service Schedule Incorporating Turbo Redemptions of the Series 2017B Subordinate Bonds", but, as of the date of such redemption, have not been paid with respect to each Series 2017B Subordinate Bond, and (2) in whole or in part, in applicable authorized denominations, on any date on or after June 1, ____, from any maturity selected by TSASC in its discretion and on such basis as the Indenture Trustee shall deem fair and appropriate, including by lot, within a maturity.

* Preliminary; subject to change.

Mandatory Redemption of Series 2017A Senior Bonds from Mandatory Sinking Fund Installments

The Series 2017A Senior Bonds maturing on June 1, 2041 are Term Bonds subject to mandatory redemption from Mandatory Sinking Fund Installments at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest, on the dates and in the amounts set forth below:

June 1,	Mandatory Sinking Fund Installment
2037	$25,300,000
2038	25,180,000
2039	25,625,000
2040	25,715,000
2041†	24,880,000

† Stated maturity.

TSASC may credit against any annual amount subject to mandatory redemption the principal amount of any Series 2017A Senior Bonds of the same maturity that have been defeased, purchased for cancellation or redeemed and not previously so credited.

Turbo Redemptions of Series 2017B Subordinate Bonds

The Series 2017B Subordinate Bonds shall be subject to special mandatory Turbo Redemption, in whole or in part, in applicable authorized denominations, at a redemption price of 100% of the principal amount thereof to be redeemed, without premium, plus interest accrued thereon to the date fixed for redemption, on each Distribution Date from Turbo Available Collections, as described in "SECURITY FOR THE BONDS—Application of Collections." Moneys available for each such Turbo Redemption will be applied to redeem the Series 2017B Subordinate Bonds in chronological order of scheduled maturity. Turbo Redemptions are not scheduled amortization payments and are to be made only from Turbo Available Collections, if any. Failure to pay Turbo Redemptions on the Series 2017B Subordinate Bonds will not constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections. Amounts in the Liquidity Reserve Accounts will not be used to make Turbo Redemptions.

See "TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE—Projected Series 2017 Debt Service Schedule Incorporating Turbo Redemptions of the Series 2017B Subordinate Bonds" for projections of Turbo Redemptions based on the forecast contained in the IHS Global Consumption Report and the base case forecast contained in the IHS Global Tribal Sales Report.

Mandatory Redemption from Lump Sum Payments and Total Lump Sum Payments

The Series 2017 Bonds shall be redeemed in whole or in part prior to their stated maturity dates at the principal amount thereof being redeemed, without premium, (i) on any Distribution Date from Lump Sum Payments on deposit in the Lump Sum Redemption Account and (ii) on the earliest practicable Business Day from Total Lump Sum Payments on deposit in the Lump Sum Redemption Account.

Clean-Up Calls

Optional Clean-Up Call of Senior Bonds

The Senior Bonds are subject to optional redemption in whole, at the option of TSASC, at a redemption price equal to 100% of the principal amount being redeemed plus interest accrued to the redemption date at any time that the available amounts on deposit in the Pledged Accounts allocable to the Senior Bonds exceed the aggregate principal amount of, and accrued interest on, all Outstanding Senior Bonds.

Mandatory Clean-Up Call of Subordinate Bonds

The Subordinate Bonds are subject to mandatory redemption in whole, at a redemption price equal to 100% of the principal amount being redeemed plus interest accrued to the redemption date at any time that the available amounts on deposit in the Pledged Accounts allocable to the Subordinate Bonds exceed the aggregate principal amount of, and accrued interest on, all Outstanding Subordinate Bonds.

Limitations on Open Market Purchases

Moneys in the Pledged Accounts will not be used to make open market purchases of the Series 2017B Subordinate Bonds.

Moneys in the Surplus Account may be used to make open market purchases of the Series 2017A Senior Bonds at a price no greater than 100% of the principal amount thereof plus interest accrued to the date of settlement. Any Series 2017A Senior Bonds so purchased shall be delivered to the Indenture Trustee for cancellation.

Effect of Redemptions on Mandatory Sinking Fund Installments and Maturity Dates

For all purposes of the Indenture, all redemptions made from Collections shall be credited as follows: (i) the amount of any Mandatory Sinking Fund Installments for the Series 2017A Senior Bonds that are Term Bonds shall be credited against the Maturity Dates for such Series 2017A Senior Bonds in chronological order of scheduled maturity; (ii) the amount of any Turbo Redemptions shall be credited against the Maturity Dates for the Series 2017B Subordinate Bonds in chronological order of scheduled maturity and (iii) the amount of any optional redemption in part of the Series 2017A Senior Bonds that are Term Bonds shall be credited against any Mandatory Sinking Fund Installments as directed by TSASC.

Partial Redemptions

If less than all of the Series 2017 Bonds of a maturity or Mandatory Sinking Fund Installment, as applicable, are to be redeemed, the Series 2017 Bonds within such maturity or Mandatory Sinking Fund Installment to be redeemed will be redeemed on such basis as the Indenture Trustee shall deem fair and appropriate, including by lot.

So long as Cede & Co. is the registered owner of the Series 2017 Bonds, as nominee of DTC, all notices of redemption, including partial redemptions, will go only to DTC. In the case of a partial redemption of the Series 2017 Bonds, DTC's practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

Notice of Redemption

When a Bond is to be redeemed prior to its stated maturity date, the Indenture Trustee will give notice to the Owner thereof in the name of TSASC, 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 redemption date, and that from and after such date, interest thereon will cease to accrue. The Indenture Trustee will give at least 15 days' notice (or such shorter period if then permitted by DTC) 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 TSASC. Such notice may be waived by any Owners holding Bonds to be redeemed. Failure by a particular Owner to receive notice, or any defect in the notice to such Owner, 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 TSASC 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 shall take into account investment earnings which it reasonably expects to be available for application.

TSASC

TSASC is a special purpose, bankruptcy-remote local development corporation incorporated under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law. TSASC is a non-stock, membership corporation governed by a board of directors. The board of directors of TSASC will have not less than five nor more than seven directors, a majority of whom will be officials of the City. The names of TSASC's current directors and officers, and their principal occupations and offices, are set out below. The Certificate of Incorporation includes a requirement that, prior to the first meeting at which their vote on certain issues may be required, there will be two directors independent of the City whose consent is required for, among other things, any bankruptcy filing by TSASC, although this requirement may not be enforceable. Currently, TSASC has no independent directors.

The directors of TSASC are:

Name		Occupation
Dean A. Fuleihan	—	Director of Management and Budget of the City
Jacques Jiha	—	Commissioner of Finance of the City
Scott M. Stringer	—	Comptroller of the City
Melissa Mark-Viverito	—	Speaker of the City Council
Zachary W. Carter	—	Corporation Counsel of the City

The following is a brief description of the officers and certain staff members of TSASC:

Alan L. Anders, President

Mr. Anders was appointed Vice President and Treasurer in 1999 and subsequently was appointed President in 2006. Mr. Anders also serves as Deputy Director for Finance of the Office of Management and Budget of the City. Prior to joining the City in September 1990, Mr. Anders was a senior investment banker for J.P. Morgan Securities since 1977 and prior to that date was Executive Director of the Commission on Governmental Efficiency and Economy in Baltimore, Maryland. Mr. Anders is a graduate of the University of Pennsylvania and the University of Maryland Law School.

Prescott D. Ulrey, Secretary

Mr. Ulrey was appointed Assistant Secretary in 1999, and subsequently was appointed Secretary in 2013. He also serves as General Counsel at the Office of Management and Budget of the City. He is a graduate of the University of California at Berkeley, the Fletcher School of Law and Diplomacy at Tufts University and Columbia Law School.

F. Jay Olson, Vice President and Treasurer

Mr. Olson was appointed Deputy Treasurer in 2004, and subsequently was appointed Vice President and Treasurer in 2006. He also serves as Assistant Director at the Office of Management and Budget of the City. He is a graduate of Northwestern University, the University of Texas at Austin, and the John F. Kennedy School of Government at Harvard University.

Robert L. Balducci, Comptroller

Mr. Balducci was appointed Assistant Comptroller in 2009, and subsequently was appointed Deputy Comptroller in 2011 and Comptroller in 2014. He is a graduate of Baruch College of the City University of New York.

Kemraj Narine, Deputy Comptroller

Mr. Narine was appointed Assistant Comptroller in 2011, and subsequently was appointed Deputy Comptroller in 2014. He is a graduate of York College of the City University of New York.

Laura A. Tarbox, Assistant Treasurer

Ms. Tarbox was appointed Assistant Treasurer in 2014. She also serves as Unit Head at the Office of Management and Budget of the City. She is a graduate of Cornell University.

Nameca Sharma, Accounting Manager

Ms. Sharma was appointed Accounting Manager in 2015. She is a graduate of York College of the City University of New York.

THE TSR PURCHASE AGREEMENT

The following summary describes certain terms of the TSR 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 TSR Purchase Agreement. Copies of the TSR Purchase Agreement may be obtained upon written request to the Indenture Trustee.

Conveyance of Tobacco Assets

The City has sold, transferred, assigned, set over and otherwise conveyed to TSASC, without recourse (subject to the obligations in the TSR Purchase Agreement), all right, title and interest of the City in and to the Tobacco Assets.

The purchase price paid by TSASC to the City under the TSR Purchase Agreement consisted of: (i) the net proceeds of the sale of TSASC's first issuance of bonds in 1999 and (ii) TSASC's 100% beneficial ownership interest in the TSASC Tobacco Settlement Trust (the "**Trust**"). The assets of the Trust consist primarily of a security (the "**Residual Certificate**") which currently entitles the Trust to the net proceeds of TSASC's Bonds issued under the Indenture after its first issuance of bonds in 1999 (other than Refunding Bonds), and to the Unpledged TSRs received by TSASC. The City owns the sole beneficial interest in the Trust.

Covenants of the City

Protection of Title; Non-Impairment Covenant. The City will take all actions as may be required by law fully to preserve, maintain, defend, protect and confirm the interest of TSASC and the interests of the Indenture Trustee in the Tobacco Assets and in the proceeds thereof. The City will not take any action that will adversely affect TSASC's ability to receive payments made under the MSA and the Decree. Under the TSR Purchase Agreement, the City pledged and agreed with TSASC, that the City will not limit or alter the rights of TSASC to fulfill the terms of its agreements with Bondholders, or in any way impair the rights and remedies of Bondholders or the security for the Bonds until the Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Bondholders, are fully paid and discharged.

Protection of Decree and MSA. The City will not take any action and will use its best reasonable efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under the Decree and the MSA or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the Decree or the MSA, nor, without the prior written consent of TSASC and the Indenture Trustee, amend, modify, terminate, waive, or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the Decree or the TSR Purchase Agreement, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the holders of TSASC bonds.

Further Actions. Upon request of TSASC or the Indenture Trustee, the City 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 TSR Purchase Agreement. The City will promptly pay over to the Indenture Trustee the proceeds of any Tobacco Assets received by the City in error.

Tax Covenant. The City will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by TSASC on Tax-Exempt Bonds will be excludable from gross income for Federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the City will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations thereunder.

Amendment

The TSR Purchase Agreement may be amended by the City and TSASC, with the consent of the Indenture Trustee, but without the consent of any of the Bondholders: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the TSR Purchase Agreement; (c) to correct or amplify the description of the Tobacco Assets; (d) to add additional covenants for the benefit of TSASC; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the TSR Purchase Agreement that shall not, as evidenced by Rating Confirmation or an opinion of counsel delivered to the Indenture Trustee and the Indenture Trustee, adversely affect in any material respect the Bonds.

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

Assignment by TSASC

The City has acknowledged and consented to the pledge, assignment and grant of a security interest by TSASC to the Indenture Trustee of any and all right, title and interest of TSASC in, to and under the Tobacco Assets and the assignment of any or all of TSASC's rights and obligations thereunder to the Indenture Trustee.

Nonpetition Covenant

The City shall not, prior to the date which is one year and one day after the termination of the TSR Purchase Agreement, acquiesce, petition or otherwise invoke or cause TSASC or the Residual Trust to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against TSASC or the Residual Trust under any Federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of TSASC or the Residual Trust or any substantial part of its property, or ordering the winding up or liquidation of the affairs of TSASC or the Residual Trust.

Limitation of Liability of the City

Notwithstanding anything in the TSR Purchase Agreement to the contrary, no officer or employee of the City will have any liability for the representations, warranties, covenants, agreements or other obligations of the City in the TSR Purchase Agreement or in any of the certificates, notices or documents delivered pursuant to the TSR Purchase Agreement, as to all of which recourse will be had solely to the assets of the City.

PLAN OF FINANCE

TSASC currently has outstanding under the Indenture $1,144,525,000 aggregate principal amount of Tobacco Settlement Asset-Backed Bonds, Series 2006-1 (the "**Refunded Bonds**"). TSASC will apply a portion of the proceeds from the sale of the Series 2017 Bonds to establish an irrevocable escrow to refund the Refunded Bonds. Such escrowed proceeds of the Series 2017 Bonds will be deposited with The Bank of New York Mellon, as escrow agent (the "**Refunding Escrow Agent**"), pursuant to an Escrow Agreement, dated as of November 1, 2016 (the "**Refunding Escrow Agreement**"), by and between TSASC and the Refunding Escrow Agent. The amounts deposited under the Refunding Escrow Agreement will be held by the Refunding Escrow Agent and invested such that the principal of and interest on such investments, when received, will be sufficient to pay the redemption price of and interest on the Refunded Bonds upon redemption thereof. See "VERIFICATION OF MATHEMATICAL COMPUTATIONS".

ESTIMATED SOURCES AND USES OF FUNDS

TSASC will apply the proceeds of the Series 2017 Bonds, together with certain amounts available under the Indenture, to refund all of the Refunded Bonds and pay the costs of issuance of the Series 2017 Bonds. The expected application of such amounts is set forth below.

Sources of Funds:

Aggregate Principal Amount:
Original Issue Premium:
Liquidity Reserve Account for the Refunded Bonds:
Other Funds Held for the Refunded Bonds:

Total Sources

Uses of Funds:

Refunding Escrow for the Refunded Bonds:
Deposit to the Senior Liquidity Reserve Account:
Deposit to the Subordinate Liquidity Reserve Account:
Costs of Issuance[†]:
Underwriters' Discount:

Total Uses

[†] Includes legal fees, IHS Global's fees, verification agents' fees, printing costs, rating fees and certain other expenses related to the issuance of the Series 2017 Bonds.

TABLES OF SERIES 2017 BOND DEBT SERVICE AND COVERAGE

The following tables set forth the debt service requirements for the Series 2017 Bonds and projected debt service coverage for the Series 2017A Senior Bonds based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". Further, the tables assume that the Series 2017 Bonds are not optionally redeemed prior to maturity.

No assurance can be given that actual cigarette consumption in the U.S., or actual Tribal NPM Pack sales to New York non-tribal consumers, will be as assumed, or that the other assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, the amount of Pledged TSRs available to TSASC to pay the principal of and interest on the Series 2017 Bonds could be adversely affected. See "RISK FACTORS" herein.

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Projected Series 2017A Senior Bonds Debt Service and Debt Service Coverage*(1)

				Series 2017A Senior Bonds					
Calendar Year	Projected Pledged TSRs(1)	Operating Expenses (1)	Net Revenues Available for Debt Service	Principal / Mandatory Sinking Fund Installments	Interest	Debt Service	Reserve Earnings (1)	Net Debt Service	Debt Service Coverage (2)
2017	$66,763,223	($750,000)	$66,013,223	$10,510,000	$29,053,687	$39,563,687	($14,088)	$39,549,599	1.67x
2018	75,435,742	(500,000)	74,935,742	12,625,000	28,125,325	40,750,325	(22,970)	40,727,355	1.84x
2019	75,300,422	(515,000)	74,785,422	12,655,000	27,682,850	40,337,850	(68,909)	40,268,941	1.86x
2020	84,953,860	(530,450)	84,423,410	18,375,000	26,970,375	45,345,375	(344,547)	45,000,828	1.88x
2021	84,899,739	(546,364)	84,353,376	19,370,000	26,026,750	45,396,750	(459,397)	44,937,353	1.88x
2022	84,640,759	(562,754)	84,078,005	20,375,000	25,033,125	45,408,125	(574,246)	44,833,879	1.88x
2023	84,732,881	(579,637)	84,153,244	21,435,000	23,987,875	45,422,875	(574,246)	44,848,629	1.88x
2024	84,711,804	(597,026)	84,114,778	22,550,000	22,888,250	45,438,250	(574,246)	44,864,004	1.87x
2025	84,978,083	(614,937)	84,363,147	23,785,000	21,729,875	45,514,875	(574,246)	44,940,629	1.88x
2026	85,170,133	(633,385)	84,536,748	25,135,000	20,506,875	45,641,875	(574,246)	45,067,629	1.88x
2027	85,580,861	(652,387)	84,928,474	26,585,000	19,213,875	45,798,875	(574,246)	45,224,629	1.88x
2028	85,876,730	(671,958)	85,204,772	26,830,000	17,878,500	44,708,500	(574,246)	44,134,254	1.93x
2029	86,326,889	(692,117)	85,634,772	27,275,000	16,525,875	43,800,875	(574,246)	43,226,629	1.98x
2030	86,623,560	(712,880)	85,910,679	28,460,000	15,132,500	43,592,500	(574,246)	43,018,254	2.00x
2031	87,065,866	(734,267)	86,331,599	28,030,000	13,720,250	41,750,250	(574,246)	41,176,004	2.10x
2032	87,370,273	(756,295)	86,613,978	27,745,000	12,325,875	40,070,875	(574,246)	39,496,629	2.19x
2033	87,827,012	(778,984)	87,048,028	26,790,000	10,962,500	37,752,500	(574,246)	37,178,254	2.34x
2034	88,084,546	(802,353)	87,282,193	26,760,000	9,623,750	36,383,750	(574,246)	35,809,504	2.44x
2035	88,476,178	(826,424)	87,649,754	26,165,000	8,300,625	34,465,625	(574,246)	33,891,379	2.59x
2036	88,722,109	(851,217)	87,870,892	26,230,000	6,990,750	33,220,750	(574,246)	32,646,504	2.69x
2037	89,098,065	(876,753)	88,221,312	25,300,000	5,702,500	31,002,500	(574,246)	30,428,254	2.90x
2038	89,319,423	(903,056)	88,416,368	25,180,000	4,440,500	29,620,500	(574,246)	29,046,254	3.04x
2039	89,678,859	(930,147)	88,748,712	25,625,000	3,170,375	28,795,375	(574,246)	28,221,129	3.14x
2040	89,849,551	(958,052)	88,891,499	25,715,000	1,886,875	27,601,875	(574,246)	27,027,629	3.29x
2041	90,153,004	(986,793)	89,166,210	24,880,000	622,000	25,502,000	(287,123)	25,214,877	3.54x
Total	$2,131,639,571	($17,963,235)	$2,113,676,336	$584,385,000	$398,501,737	$982,886,737	($12,107,702)	$970,779,035	

* Preliminary, subject to change.

(1) Based on the application of the Pledged TSRs Projection Methodology and Assumptions (including forecasts for cigarette consumption and Tribal NPM Pack sales prepared by IHS Global) described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

(2) Series 2017A Senior Bonds Debt Service Coverage equals Net Revenues Available for Debt Service divided by Series 2017A Senior Bonds Net Debt Service.

Projected Series 2017 Debt Service Schedule Incorporating Turbo Redemptions of the Series 2017B Subordinate Bonds*(1)

		Series 2017A Senior Bonds				Series 2017B Subordinate Bonds							
Calendar Year	Projected Net Revenues Available for Debt Service(1)	Principal / Mandatory Sinking Fund Installments	Interest	Reserve Earnings / Release(2)	Series 2017A Senior Bonds Net Debt Service	2042 Term	2045 Term	2052 Term	Total Projected Turbo Redemptions(3)	Interest	Reserve Earnings / Release(2)	Series 2017B Subordinate Bonds Net Debt Service	Total Net Debt Service(4)
2017	$66,013,223	$10,510,000	$29,053,687	($14,088)	$39,549,599	$6,010,000	-	-	$6,010,000	$20,456,517	($6,301)	$26,460,216	$66,009,814
2018	74,935,742	12,625,000	28,125,325	(22,970)	40,727,355	14,520,000	-	-	14,520,000	19,701,900	(10,273)	34,211,627	74,938,982
2019	74,785,422	12,655,000	27,682,850	(68,909)	40,268,941	15,290,000	-	-	15,290,000	19,254,750	(30,820)	34,513,930	74,782,871
2020	84,423,410	18,375,000	26,970,375	(344,547)	45,000,828	20,865,000	-	-	20,865,000	18,712,425	(154,100)	39,423,325	84,424,153
2021	84,353,376	19,370,000	26,026,750	(459,397)	44,937,353	21,545,000	-	-	21,545,000	18,076,275	(205,467)	39,415,808	84,353,162
2022	84,078,005	20,375,000	25,033,125	(574,246)	44,833,879	16,770,000	5,365,000	-	22,135,000	17,367,425	(256,833)	39,245,592	84,079,471
2023	84,153,244	21,435,000	23,987,875	(574,246)	44,848,629	-	23,155,000	-	23,155,000	16,402,875	(256,833)	39,301,042	84,149,671
2024	84,114,778	22,550,000	22,888,250	(574,246)	44,864,004	-	24,295,000	-	24,295,000	15,216,625	(256,833)	39,254,792	84,118,796
2025	84,363,147	23,785,000	21,729,875	(574,246)	44,940,629	-	25,710,000	-	25,710,000	13,966,500	(256,833)	39,419,667	84,360,296
2026	84,536,748	25,135,000	20,506,875	(574,246)	45,067,629	-	27,080,000	-	27,080,000	12,646,750	(256,833)	39,469,917	84,537,546
2027	84,928,474	26,585,000	19,213,875	(574,246)	45,224,629	-	28,710,000	-	28,710,000	11,252,000	(256,833)	39,705,167	84,929,796
2028	85,204,772	26,830,000	17,878,500	(574,246)	44,134,254	-	685,000	30,895,000	31,580,000	9,744,750	(256,833)	41,067,917	85,202,171
2029	85,634,772	27,275,000	16,525,875	(574,246)	43,226,629	-	-	34,575,000	34,575,000	8,090,875	(256,833)	42,409,042	85,635,671
2030	85,910,679	28,460,000	15,132,500	(574,246)	43,018,254	-	-	36,845,000	36,845,000	6,305,375	(256,833)	42,893,542	85,911,796
2031	86,331,599	28,030,000	13,720,250	(574,246)	41,176,004	-	-	41,055,000	41,055,000	4,357,875	(256,833)	45,156,042	86,332,046
2032	86,613,978	27,745,000	12,325,875	(574,246)	39,496,629	-	-	45,170,000	45,170,000	2,202,250	(256,833)	47,115,417	86,612,046
2033	87,048,028	26,790,000	10,962,500	(574,246)	37,178,254	-	-	21,460,000	21,460,000	536,500	(20,675,083)	1,321,417	38,499,671
2034	87,282,193	26,760,000	9,623,750	(574,246)	35,809,504	-	-	-	-	-	-	-	35,809,504
2035	87,649,754	26,165,000	8,300,625	(574,246)	33,891,379	-	-	-	-	-	-	-	33,891,379
2036	87,870,892	26,230,000	6,990,750	(574,246)	32,646,504	-	-	-	-	-	-	-	32,646,504
2037	88,221,312	25,300,000	5,702,500	(574,246)	30,428,254	-	-	-	-	-	-	-	30,428,254
2038	88,416,368	25,180,000	4,440,500	(574,246)	29,046,254	-	-	-	-	-	-	-	29,046,254
2039	88,748,712	25,625,000	3,170,375	(574,246)	28,221,129	-	-	-	-	-	-	-	28,221,129
2040	88,891,499	25,715,000	1,886,875	(574,246)	27,027,629	-	-	-	-	-	-	-	27,027,629
2041	89,166,210	24,880,000	622,000	(46,226,776)	(20,724,776)	-	-	-	-	-	-	-	(20,724,776)
Total	$2,113,676,336	$584,385,000	$398,501,737	($58,047,355)	$924,839,382	$95,000,000	$135,000,000	$210,000,000	$440,000,000	$214,291,667	($23,907,211)	$630,384,456	$1,555,223,838

* Preliminary, subject to change.

(1) Based on the application of the Pledged TSRs Projection Methodology and Assumptions (including forecasts for cigarette consumption and Tribal NPM Pack sales prepared by IHS Global) described in "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

(2) Includes releases from the Liquidity Reserve Accounts upon final payment of each series of Series 2017 Bonds.

(3) Turbo Redemptions are mandatory payments to the extent of Turbo Available Collections. Failure to pay Turbo Redemptions on the Series 2017B Subordinate Bonds will not constitute a Subordinate Payment Default or any other Event of Default under the Indenture to the extent that such failure results from an insufficiency of Turbo Available Collections. The projected Turbo Redemptions set forth herein are based on the forecast contained in the IHS Global Consumption Report and the base case forecast contained in the IHS Global Tribal Sales Report.

(4) Includes all Interest, Series 2017A Senior Bonds principal and Mandatory Sinking Fund Installments, Series 2017B Subordinate Bonds projected Turbo Redemptions, less assumed earnings and releases on the Liquidity Reserve Accounts.

SERIES 2017B SUBORDINATE BONDS PROJECTED TURBO REDEMPTIONS UNDER VARIOUS CONSUMPTION DECLINE SCENARIOS AND VARIOUS TRIBAL NPM PACK SALES SCENARIOS

Projected Turbo Redemptions Under Various Consumption Decline Scenarios

The following table sets forth the expected final redemption date at which each maturity of the Series 2017B Subordinate Bonds would be paid in full, and the expected average life of each such maturity from the delivery date of the Series 2017B Subordinate Bonds, based on the following cigarette consumption decline scenarios:

- IHS Global Base Case Forecast;
- -4% constant annual decline beginning in 2016;
- -5% constant annual decline beginning in 2016; and
- -6.01%* constant annual decline beginning in 2016.

The -6.01%* constant annual decline represents the "breakeven" consumption decline rate at which debt service on all Series 2017B Subordinate Bonds would be timely paid in full at final scheduled maturity.

The table below assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" with the following exceptions:

- the Volume Adjustment utilizes the above-listed assumptions for cigarette consumption in the U.S.; and
- for each constant decline scenario, for purposes of projecting Variable Tribal NPM Packs Credits, it is assumed that Tribal NPM Packs sales to New York consumers in each year is equal to the level of U.S. cigarette consumption for each scenario multiplied by the ratio where the numerator is the applicable base case forecast contained in the IHS Global Tribal Sales Report and the denominator is the base case forecast of national cigarette consumption contained in the IHS Global Consumption Report for each applicable year.

Further, the table assumes that the Series 2017 Bonds are not optionally redeemed prior to maturity.

No assurance can be given that actual cigarette consumption in the U.S., or actual Tribal NPM Pack sales to New York non-tribal consumers, will be as assumed, or that the other assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, the amount of Pledged TSRs available to TSASC to pay the principal of and interest on the Series 2017 Bonds could be adversely affected. See "RISK FACTORS" herein.

* Preliminary, subject to change.

Projected Principal Repayment for Series 2017B Subordinate Bonds
Under Various Consumption Decline Scenarios*(1)

		IHS Global Forecast		4.00% Annual Decline		5.00% Annual Decline		6.01% Annual Decline (Breakeven)	
Maturity	Principal	Final Redemption	Avg. Life	Final Redemption	Avg. Life	Final Redemption	Avg. Life	Final Redemption	Avg. Life
6/1/2042	$95,000,000	6/1/2022	3.45	6/1/2023	3.64	6/1/2024	4.25	6/1/2041	9.12
6/1/2045	135,000,000	6/1/2028	8.52	6/1/2029	9.66	6/1/2036	14.28	6/1/2045	27.14
6/1/2052	210,000,000	6/1/2033	14.00	6/1/2036	16.67	6/1/2042	23.66	6/1/2052	33.04
Total	$440,000,000								

* Preliminary, subject to change.

(1) With the exception that the Volume Adjustment utilizes the above-listed assumptions for cigarette consumption in the U.S. and the Variable Tribal NPM Packs Credits are projected as described in the preceding paragraphs, the table assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

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Projected Turbo Redemptions Under Various Tribal NPM Pack Sales Scenarios

The following table sets forth the expected final redemption date at which each maturity of the Series 2017B Subordinate Bonds would be paid in full, and the expected average life of each such maturity from the delivery date of the Series 2017B Subordinate Bonds, based on the following Tribal NPM Pack sales scenarios:

- IHS Global Tribal NPM Pack Forecast;
- IHS Global Tribal NPM Pack Forecast – High Scenario;
- IHS Global Tribal NPM Pack Forecast – Low Scenario; and
- No sales of Tribal NPM Packs to New York non-tribal consumers.

With the exception that the NY NPM Settlement credits utilize the above-listed assumptions for Tribal NPM Packs sold to New York non-tribal consumers, the table below assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". Further, the table assumes that the Series 2017 Bonds are not optionally redeemed prior to maturity.

No assurance can be given that actual cigarette consumption in the U.S., or actual Tribal NPM Pack sales to New York non-tribal consumers, will be as assumed, or that the other assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, the amount of Pledged TSRs available to TSASC to pay the principal of and interest on the Series 2017 Bonds could be adversely affected. See "RISK FACTORS" herein.

Projected Principal Repayment for Series 2017B Subordinate Bonds
Under Various Tribal NPM Pack Sales Scenarios*

		IHS Global Base Tribal NPM Packs Sales Forecast(1)		IHS Global High Tribal NPM Packs Sales Scenario(1)		IHS Global Low Tribal NPM Packs Sales Scenario(1)		No Tribal NPM Packs Sales(2)	
Maturity	Principal	Final Redemption	Avg. Life	Final Redemption	Avg. Life	Final Redemption	Avg. Life	Final Redemption	Avg. Life
6/1/2042	$95,000,000	6/1/2022	3.45	6/1/2023	3.58	6/1/2022	3.31	6/1/2022	2.96
6/1/2045	135,000,000	6/1/2028	8.52	6/1/2028	8.87	6/1/2027	8.29	6/1/2026	7.61
6/1/2052	210,000,000	6/1/2033	14.00	6/1/2033	14.32	6/1/2032	13.64	6/1/2031	12.75
Total	$440,000,000								

* Preliminary, subject to change.

(1) With the exception that the Variable Tribal NPM Packs Credits are projected as described in the preceding paragraphs, assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions (including the forecast for cigarette consumption prepared by IHS Global) and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

(2) With the exception that no Variable Tribal NPM Packs Credits are projected, assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions (including the forecast for cigarette consumption prepared by IHS Global) and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

BREAKEVEN CONSUMPTION AND REVENUE DECLINE RATES BY MATURITY

The following table sets forth the "breakeven" constant annual rate of consumption decline at which each maturity of the Series 2017 Bonds would be paid in full at maturity both with and without Variable Tribal NPM Packs Credits.

The table below assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" with the following exceptions:

- the Volume Adjustment utilizes the listed "breakeven" assumption for cigarette consumption in the U.S.; and
- for each "breakeven" constant decline scenario, for purposes of projecting Variable Tribal NPM Packs Credits, it is assumed that Tribal NPM Packs sales to New York consumers in each year is equal to the level of U.S. cigarette consumption for each scenario multiplied by the ratio where the numerator is the applicable base case forecast contained in the IHS Global Tribal Sales Report and the denominator is the base case forecast of national cigarette consumption contained in the IHS Global Consumption Report for each applicable year.

Further, the table assumes that the Series 2017 Bonds are not optionally redeemed prior to maturity.

No assurance can be given that actual cigarette consumption in the U.S., or actual Tribal NPM Pack sales to New York non-tribal consumers, will be as assumed, or that the other assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, including the market shares of the OPMs and the SPMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Pledged TSRs Projection Methodology and Assumptions, the amount of Pledged TSRs available to TSASC to pay the principal of and interest on the Series 2017 Bonds could be adversely affected. See "RISK FACTORS" herein.

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Series 2017 Bonds Breakeven Consumption Decline Rates By Maturity*(1)

	Maturity	Principal	Type	Maximum Consumption Declines Assuming No Tribal NPM Packs Sales(2)	Maximum Consumption Declines Assuming Base Case IHS Tribal NPM Packs Forecasts(3)
Series 2017A Senior Bonds:	6/1/2017	$10,510,000	Serial	-100.00%	-100.00%
	6/1/2018	12,625,000	Serial	-68.65%	-64.15%
	6/1/2019	12,655,000	Serial	-47.14%	-44.39%
	6/1/2020	18,375,000	Serial	-36.41%	-34.77%
	6/1/2021	19,370,000	Serial	-29.59%	-28.34%
	6/1/2022	20,375,000	Serial	-24.76%	-23.98%
	6/1/2023	21,435,000	Serial	-21.49%	-20.80%
	6/1/2024	22,550,000	Serial	-18.98%	-18.42%
	6/1/2025	23,785,000	Serial	-16.76%	-16.31%
	6/1/2026	25,135,000	Serial	-15.06%	-14.67%
	6/1/2027	26,585,000	Serial	-13.72%	-13.39%
	6/1/2028	26,830,000	Serial	-12.70%	-12.38%
	6/1/2029	27,275,000	Serial	-11.85%	-11.57%
	6/1/2030	28,460,000	Serial	-11.17%	-10.92%
	6/1/2031	28,030,000	Serial	-10.66%	-10.42%
	6/1/2032	27,745,000	Serial	-10.25%	-10.03%
	6/1/2033	26,790,000	Serial	-9.96%	-9.75%
	6/1/2034	26,760,000	Serial	-9.73%	-9.53%
	6/1/2035	26,165,000	Serial	-9.55%	-9.36%
	6/1/2036	26,230,000	Serial	-9.41%	-9.22%
	6/1/2041	126,700,000	Term	-9.05%	-8.89%
	TOTAL	$584,385,000			
Series 2017B Subordinate Bonds:	6/1/2042	$95,000,000	Turbo Term	-6.24%	-6.02%
	6/1/2045	135,000,000	Turbo Term	-6.24%	-6.02%
	6/1/2052	210,000,000	Turbo Term	-6.24%	-6.01%
	TOTAL	$440,000,000			

* Preliminary, subject to change.

(1) Assumes the Senior Liquidity Reserve Account and the Subordinate Liquidity Reserve Account are used to pay debt service on or prior to the final maturity of the respective series of Series 2017 Bonds without a payment default.

(2) With the exception that the Volume Adjustment utilizes the above-listed assumptions for cigarette consumption in the U.S. and no Variable Tribal NPM Pack Credits are projected, the table assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

(3) With the exception that the Volume Adjustment utilizes the above-listed assumptions for cigarette consumption in the U.S. and the Variable Tribal NPM Pack Credits are projected as described in the preceding paragraphs, the table assumes that Pledged TSRs are received based on the application of the Pledged TSRs Projection Methodology and Assumptions and the Bond Structuring Assumptions described herein under "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

PLEDGED TSRS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to project the amount of Pledged TSRs to be received by TSASC (the "**Pledged TSRs Projection Methodology and Assumptions**") as well as the methodology and assumptions used to calculate debt service coverage on the Series 2017A Senior Bonds and the projected Turbo Redemptions of the Series 2017B Subordinate Bonds (the "**Bond Structuring Assumptions**").

The assumptions set forth herein are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed herein. If actual results are different from those assumed, it could have a material effect on the receipt of Pledged TSRs. See "RISK FACTORS" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" herein. The discussions are followed by tables of projected Pledged TSRs to be received by the Indenture Trustee.

In projecting the amount of Pledged TSRs, (a) the forecast of cigarette consumption in the U.S. developed by IHS Global as described in the IHS Global Consumption Report is assumed to represent actual cigarette shipments measured pursuant to the MSA for the years covered by the report, (b) the forecast of Tribal NPM Pack sales developed by IHS Global as described in the IHS Global Tribal Sales Report is assumed to represent the actual estimates of Tribal NPM Packs sold to New York non-tribal consumers made by the Investigator pursuant to the terms of the NY NPM Settlement, and (c) both such forecasts are applied to calculate Annual Payments to be made by the PMs pursuant to the MSA, as adjusted pursuant to the NY NPM Settlement. See "RISK FACTORS – Risks Related to the IHS Global Reports" herein. The calculation of payments required to be made was performed in accordance with the terms of the MSA and the NY NPM Settlement; however, as described below, certain further assumptions were made with respect to shipments of cigarettes in the U.S., Tribal NPM Pack sales to New York non-tribal consumers, and the applicability to such payments of certain adjustments and offsets set forth in the MSA and the NY NPM Settlement. Such further assumptions may differ materially from the actual information utilized by the MSA Auditor and the Investigator in calculating payments due under the MSA as adjusted by the NY NPM Settlement.

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

- the PMs make all payments required to be made by them pursuant to the MSA,
- the aggregate Market Share of the OPMs remains constant throughout the forecast period at 83.52629%, based on sales year 2015 OPM cigarette shipments of 226,214,000,000 divided by total net market cigarette shipments of 270,829,703,556 as reported by NAAG (each measuring roll-your-own shipments at 0.0325 ounces per cigarette conversion rate), and
- the aggregate Market Share of the SPMs remains constant at 8.60109%, based on the NAAG-reported market share for SPMs in sales year 2015 (measuring roll-your-own shipments at 0.09 ounces per cigarette conversion rate).

No calculation of Strategic Contribution Payments is made, as no portion of such payments are allocated under the Decree to the City.

Pledged TSRs Projection Methodology and Assumptions

Cigarette Shipments under the MSA

In applying the consumption forecast from the IHS Global Consumption Report, it was assumed that U.S. consumption forecasted by IHS Global was equal to the number of cigarettes shipped in and to the U.S., the District of Columbia and Puerto Rico, which, when adjusted by the aggregate OPM Market Share, is the number used to determine the Volume Adjustment. The IHS Global Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors, such as

inventory adjustments, but are substantially the same when compared over a period of time. IHS Global's forecast for U.S. cigarette consumption is set forth in the IHS Global Consumption Report in APPENDIX A-1 – "IHS GLOBAL CONSUMPTION REPORT." The IHS Global Consumption Report contains a discussion of the assumptions underlying the projections of cigarette consumption contained therein. No assurance can be given that future consumption will be consistent with that projected in the IHS Global Consumption Report. See "RISK FACTORS – Risks Relating to the IHS Global Reports."

In applying the forecast of Tribal NPM Pack sales, it was assumed that the Tribal NPM Packs sales forecasted by IHS Global will be equal to sales to New York non-tribal consumers determined by the Investigator pursuant to the NY NPM Settlement. IHS Global's forecast for Tribal NPM Pack sales is set forth in the IHS Global Tribal Sales Report in APPENDIX A-2 – "IHS GLOBAL TRIBAL SALES REPORT". The IHS Global Tribal Sales Report contains a discussion of the assumptions underlying the projections of Tribal NPM Pack sales contained therein. No assurance can be given that future Tribal NPM Pack sales will be consistent with that projected in the IHS Global Tribal Sales Report. See "RISK FACTORS – Risks Relating to the IHS Global Reports."

Annual Payments

In accordance with the Pledged TSRs Projection Methodology and Assumptions, the anticipated amounts of Annual Payments to be made by the OPMs for the years 2017-2052 were calculated by applying the adjustments applicable to the base amounts of Annual Payments set out in the MSA, in order, as described below. The anticipated amounts of Annual Payments to be made by the SPMs for the years 2017-2052 were calculated by (i) multiplying the base amounts of Annual Payments by the Adjusted SPM Market Share (as described below) and (ii) then applying the adjustments applicable to the Annual Payments set out in the MSA, in order, as described below.

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

Volume Adjustment. Next, the Annual Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by multiplying the forecast for U.S. cigarette consumption contained in the IHS Global Consumption Report by the assumed aggregate OPM Market Share of the OPMs (83.52629% as described above). No add-back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments–*Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously Settled States Reduction. Next, the Annual Payments calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously Settled States Reduction, which applies only to the payments owed by the OPMs. The Previously Settled States Reduction is not applicable to Annual Payments owed by the SPMs. The Previously Settled States Reduction is as follows for each year of the following periods:

2017	12.2373756%
2018 and after	11.0666667%

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

NPM Adjustment for Sales Year 2016 and Later Years. The Pledged TSRs Projection Methodology and Assumptions include an assumption that with respect to any future Annual Payment to the State the NPM Adjustments taken by the OPMs and the SA SPMs in the year of payment will be evenly offset by the deposits made to the DPA by the OPMs and SA SPMs and immediately released to the State.

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

Litigating Releasing Parties Offset. The Pledged TSRs Projection Methodology and Assumptions include an assumption that the Litigating Releasing Parties Offset will have no effect on payments.

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

Subsequent Participating Manufacturers. The Pledged TSRs Projection Methodology and Assumptions treat the SPMs as a single manufacturer having executed the MSA on or prior to February 22, 1998 for purposes of calculating Annual Payments under Section IX(i) of the MSA. Further, the Market Share (as defined in the MSA) of the SPMs remains constant at 8.60109% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate) as described above. Because the 8.60109% Market Share exceeds the greater of (i) the SPM's 1998 Market Share or (ii) 125% of its 1997 Market Share, the SPMs are assumed to make Annual Payments in each year. For purposes of calculating Annual Payments owed by the SPMs, their aggregate adjusted Market Share ("**Adjusted SPM Market Share**") is equal to (y) the SPM Market Share (assumed at 8.60109%) less the Base Share (assumed at 3.492895%) divided by (z) the aggregate Market Share of the OPMs at 84.80120% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate), or 6.02373%.

NY NPM Settlement Credits. The Pledged TSRs Projection Methodology and Assumptions also include assumptions that (a) the NY NPM Settlement will remain in force, (b) based on the history of escrow deposits being made on NPM cigarettes on which the State collects SET, the Non-Compliant SET-Paid NPM Sales Credit will be zero in all future years, and (c) the SA PMs will be entitled to take in all future years a Variable Tribal Packs Credit in an amount calculated under the terms of the NY NPM Settlement on the basis of Tribal NPM Packs sales after 2014 equal to the base case forecast of IHS Global in the IHS Global Tribal Sales Report using only the forecasts for odd numbered years and applying those forecasts in the following year. It is also assumed that (y) the Fixed Tribal Packs Credits for years 2012 through 2014 as described in the NY NPM Settlement will be taken by the SA PMs in 2017, 2018, and 2019 and that TSASC's allocable share of such credits is attributable only to Annual Payments due in years 2012 through 2014, and (z) that the Variable Tribal Packs Credits for 2015 and subsequent years will be taken beginning in 2017 as described herein. See "NY NPM SETTLEMENT" AND APPENDIX A-2—"IHS GLOBAL TRIBAL SALES REPORT".

State Allocation Percentage. The amount of Annual Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction for each year was multiplied by the State Allocation Percentage (12.7620310%) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the State.

Decree Allocation Percentage for the City. The amount of Annual Payments in each year to be allocated to the State, calculated as described in the preceding paragraph, was multiplied by the percentage of such payments that is allocated to the City pursuant to the Decree (26.67%) in order to determine the amount of Annual Payments projected to be received by TSASC in each year.

Pledged TSRs. The amount of Annual Payments in each year to be allocated to TSASC, calculated as described in the preceding two paragraphs, was then multiplied by the percentage of TSASC's TSRs that are pledged under the Indenture: 37.40%.

Receipt and Application of Pledged TSRs

It is assumed that the Indenture Trustee will receive Pledged TSRs representing the pledged portion of TSASC's share of the Annual Payments ten days after April 15 in each year, commencing in 2017, and will apply receipts, together with interest earnings in the Accounts held by the Indenture Trustee, as provided in the Indenture. See "SECURITY FOR THE BONDS—Application of Collections."

Projection of Pledged TSRs to be Received by the Indenture Trustee

The following tables show the projection of Pledged TSRs to be received by the Indenture Trustee through the year 2052, calculated in accordance with the Pledged TSRs Projection Methodology and Assumptions and utilizing the base case forecasts from both the IHS Global Consumption Report and the IHS Global Tribal Sales Report. Table 1 provides a projection of the Pledged TSRs, as adjusted by the NY NPM Settlement. Table 2 provides a calculation of Fixed Tribal NPM Packs Credits relating to years 2012 to 2014, which relate to payment years 2017 to 2019. Table 3 provides projected Variable Tribal NPM Packs Credits based on Tribal NPM Packs sales forecast (base case) in the IHS Global Tribal Sales Report and calculated in accordance with the NY NPM Settlement as further described above.

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Table 1*
Projection of Pledged TSRs as Adjusted by NY NPM Settlement

Sales Year	Payment Year	IHS Global Consumption Decline Forecast	IHS Global Forecast of Cigarette Consumption	Estimated OPM Consumption	Base Annual Payment	Inflation Adjustment	Volume Adjustment	Previously Settled State's Reduction	Total Adjusted Annual Payments by OPMs	New York State TSR Allocation	OPM Annual Payments	SPM Annual Payments	Fixed Tribal NPM Packs Credits(1)	Variable Tribal NPM Packs Credits(2)	Total NYS Annual Payments	Applicable Percentage (3)	Pledged TSRs
2016	2017	-3.477%	261,411,999,818	218,347,745,063	$8,139,000,000	$6,006,870,935	($7,499,227,125)	($813,374,768)	$5,833,269,042	12.7620310%	$744,443,603	$51,096,090	($95,124,490)	($31,081,531)	$669,333,673	9.9745800%	$66,763,223
2017	2018	-3.585%	252,040,747,258	210,520,285,473	9,000,000,000	7,111,589,400	(8,801,155,903)	(809,021,309)	6,501,412,187	12.7620310%	829,712,239	56,198,975	(97,617,352)	(32,013,977)	756,279,885	9.9745800%	75,435,742
2018	2019	-3.566%	243,052,520,874	203,012,753,437	9,000,000,000	7,594,937,100	(9,321,878,788)	(804,885,122)	6,468,173,190	12.7620310%	825,470,268	55,911,653	(101,370,686)	(25,088,004)	754,923,230	9.9745800%	75,300,422
2019	2020	-3.495%	234,558,229,987	195,917,787,398	9,000,000,000	8,092,785,600	(9,851,395,097)	(801,380,551)	6,440,009,952	12.7620310%	821,876,066	55,668,207	-	(25,840,645)	851,703,628	9.9745800%	84,953,860
2020	2021	-3.360%	226,675,964,703	189,334,023,638	9,000,000,000	8,605,569,600	(10,385,749,897)	(798,993,383)	6,420,826,320	12.7620310%	819,427,845	55,502,381	-	(23,769,183)	851,161,044	9.9745800%	84,899,739
2021	2022	-3.282%	219,237,251,060	183,120,742,108	9,000,000,000	9,133,736,400	(10,929,457,653)	(797,273,517)	6,407,005,230	12.7620310%	817,663,994	55,382,910	-	(24,482,260)	848,564,644	9.9745800%	84,640,759
2022	2023	-3.141%	212,350,247,998	177,368,283,958	9,000,000,000	9,677,748,600	(11,478,707,535)	(796,693,880)	6,402,347,185	12.7620310%	817,069,532	55,342,646	-	(22,923,967)	849,488,211	9.9745800%	84,732,881
2023	2024	-3.016%	205,945,531,325	172,018,661,737	9,000,000,000	10,238,081,400	(12,035,109,056)	(797,128,942)	6,405,843,402	12.7620310%	817,515,721	55,372,867	-	(23,611,684)	849,276,904	9.9745800%	84,711,804
2024	2025	-2.881%	200,011,948,162	167,062,559,857	9,000,000,000	10,815,223,500	(12,598,497,711)	(798,650,990)	6,418,074,799	12.7620310%	819,076,695	55,478,597	-	(22,608,810)	851,946,483	9.9745800%	84,978,083
2025	2026	-2.776%	194,459,571,048	162,424,865,246	9,000,000,000	11,409,679,800	(13,171,468,920)	(801,028,673)	6,437,182,207	12.7620310%	821,515,189	55,643,764	-	(23,287,075)	853,871,877	9.9745800%	85,170,133
2026	2027	-2.706%	189,197,556,287	158,029,699,538	9,000,000,000	12,021,970,500	(13,756,975,848)	(803,992,744)	6,461,001,908	12.7620310%	824,555,066	55,849,664	-	(22,415,110)	857,989,621	9.9745800%	85,580,861
2027	2028	-2.666%	184,154,257,518	153,817,219,182	9,000,000,000	12,652,629,300	(14,357,608,648)	(807,315,621)	6,487,705,031	12.7620310%	827,962,927	56,080,489	-	(23,087,562)	860,955,854	9.9745800%	85,876,730
2028	2029	-2.663%	179,250,209,423	149,721,049,748	9,000,000,000	13,302,207,900	(14,976,553,732)	(810,705,730)	6,514,948,438	12.7620310%	831,439,739	56,315,984	-	(22,286,815)	865,468,909	9.9745800%	86,326,889
2029	2030	-2.677%	174,451,253,724	145,712,660,094	9,000,000,000	13,971,274,200	(15,615,559,465)	(814,032,433)	6,541,682,302	12.7620310%	834,851,523	56,547,075	-	(22,955,418)	868,443,180	9.9745800%	86,623,560
2030	2031	-2.684%	169,769,817,327	141,802,429,953	9,000,000,000	14,660,412,300	(16,274,641,449)	(817,358,643)	6,568,412,208	12.7620310%	838,262,802	56,778,131	-	(22,163,423)	872,877,511	9.9745800%	87,065,866
2031	2032	-2.681%	165,217,873,397	138,000,360,066	9,000,000,000	15,370,224,300	(16,953,783,423)	(820,752,793)	6,595,688,084	12.7620310%	841,743,758	57,013,907	-	(22,828,325)	875,929,340	9.9745800%	87,370,273
2032	2033	-2.680%	160,790,597,635	134,302,420,873	9,000,000,000	16,101,331,200	(17,653,641,836)	(824,210,959)	6,623,478,405	12.7620310%	845,290,367	57,254,130	-	(22,036,126)	880,508,371	9.9745800%	87,827,012
2033	2034	-2.749%	156,370,339,831	130,610,343,521	9,000,000,000	16,854,371,100	(18,379,920,951)	(827,172,486)	6,647,277,663	12.7620310%	848,327,636	57,459,854	-	(22,697,211)	883,090,279	9.9745800%	88,084,546
2034	2035	-2.769%	152,040,527,596	126,993,811,998	9,000,000,000	17,630,001,900	(19,129,743,416)	(830,028,608)	6,670,229,876	12.7620310%	851,256,805	57,658,255	-	(21,898,484)	887,016,575	9.9745800%	88,476,178
2035	2036	-2.776%	147,819,539,258	123,468,177,037	9,000,000,000	18,428,902,200	(19,902,876,964)	(832,880,129)	6,693,145,108	12.7620310%	854,181,254	57,856,337	-	(22,555,439)	889,482,152	9.9745800%	88,722,109
2036	2037	-2.802%	143,677,916,049	120,008,832,825	9,000,000,000	19,251,769,500	(20,701,323,130)	(835,582,734)	6,714,863,636	12.7620310%	856,952,979	58,044,075	-	(21,745,761)	893,251,292	9.9745800%	89,098,065
2037	2038	-2.819%	139,627,813,484	116,625,932,411	9,000,000,000	20,099,322,900	(21,525,180,446)	(838,205,101)	6,735,937,353	12.7620310%	859,642,413	58,226,238	-	(22,398,132)	895,470,519	9.9745800%	89,319,423
2038	2039	-2.835%	135,668,871,960	113,319,175,433	9,000,000,000	20,972,302,200	(22,375,135,451)	(840,753,123)	6,756,413,626	12.7620310%	862,255,601	58,403,238	-	(21,584,802)	899,074,037	9.9745800%	89,678,859
2039	2040	-2.892%	131,745,231,103	110,041,903,792	9,000,000,000	21,871,471,500	(23,254,840,154)	(842,907,205)	6,773,724,142	12.7620310%	864,464,775	58,552,872	-	(22,232,345)	900,785,302	9.9745800%	89,849,551
2040	2041	-2.916%	127,903,844,553	106,833,336,122	9,000,000,000	22,797,615,600	(24,162,688,297)	(844,931,957)	6,789,995,345	12.7620310%	866,541,311	58,693,522	-	(21,407,268)	903,827,565	9.9745800%	90,153,004
2041	2042	-2.894%	124,202,817,987	103,742,005,940	9,000,000,000	23,751,544,500	(25,096,167,340)	(847,195,075)	6,808,182,085	12.7620310%	868,862,308	58,850,730	-	(22,049,486)	905,663,553	9.9745800%	90,336,136
2042	2043	-2.933%	120,560,478,167	100,699,694,619	9,000,000,000	24,734,090,700	(26,060,501,316)	(849,210,561)	6,824,378,823	12.7620310%	870,929,341	58,990,737	-	(21,220,194)	908,699,884	9.9745800%	90,638,997
2043	2044	-2.962%	116,989,895,608	97,717,319,476	9,000,000,000	25,746,113,700	(27,055,818,402)	(851,059,349)	6,839,235,949	12.7620310%	872,825,412	59,119,164	-	(21,856,799)	910,087,777	9.9745800%	90,777,433
2044	2045	-2.983%	113,500,068,047	94,802,395,987	9,000,000,000	26,788,497,300	(28,082,426,408)	(852,805,181)	6,853,265,711	12.7620310%	874,615,895	59,240,439	-	(21,023,489)	912,832,844	9.9745800%	91,051,242
2045	2046	-3.003%	110,091,380,395	91,955,245,654	9,000,000,000	27,862,152,300	(29,141,133,364)	(854,459,431)	6,866,559,504	12.7620310%	876,312,453	59,355,352	-	(21,654,194)	914,013,610	9.9745800%	91,169,019
2046	2047	-3.009%	106,779,262,148	89,188,756,161	9,000,000,000	28,968,016,500	(30,231,778,422)	(856,143,683)	6,880,094,395	12.7620310%	878,039,780	59,472,349	-	(20,818,772)	916,693,357	9.9745800%	91,436,312
2047	2048	-3.014%	103,561,152,314	86,500,788,409	9,000,000,000	30,107,057,400	(31,355,309,075)	(857,860,151)	6,893,888,175	12.7620310%	879,800,146	59,591,584	-	(21,443,335)	917,948,395	9.9745800%	91,561,497
2048	2049	-3.019%	100,434,552,830	83,889,255,857	9,000,000,000	31,280,269,500	(32,512,699,586)	(859,611,073)	6,907,958,841	12.7620310%	881,595,849	59,713,212	-	(20,642,961)	920,666,100	9.9745800%	91,832,577
2049	2050	-3.024%	97,397,027,147	81,352,123,347	9,000,000,000	32,488,677,900	(33,704,954,006)	(861,398,780)	6,922,325,114	12.7620310%	883,429,277	59,837,396	-	(21,262,250)	922,004,423	9.9745800%	91,966,069
2050	2051	-3.030%	94,446,198,845	78,887,405,941	9,000,000,000	33,733,338,300	(34,933,106,332)	(863,225,674)	6,937,006,294	12.7620310%	885,302,894	59,964,302	-	(20,475,763)	924,791,433	9.9745800%	92,244,061
2051	2052	-3.035%	91,579,750,278	76,493,167,799	9,000,000,000	35,015,338,800	(36,198,222,139)	(865,094,246)	6,952,022,414	12.7620310%	887,219,256	60,094,103	-	(21,090,037)	926,223,322	9.9745800%	92,386,886

* Preliminary, subject to change.

(1) See Table 2 - Calculation of Annual Fixed Tribal NPM Packs Credits (Relating to Payment Years 2017 to 2019).

(2) See Table 3 - Calculation of Annual Variable Tribal NPM Packs Credits (Relating to Payment Year 2017 and Subsequent Years).

(3) Is the product of the City's share of New York State's Annual Payments (26.67%) and the portion of the City's Tobacco Assets pledged under the Indenture (37.40%).

Table 2
Projection of Fixed Tribal NPM Packs Credits against State Annual Payments
(Relating to Payment Years 2017 to 2019)

Sales Year	Payment Year	Total OPM's Credit (1)	SPM's Potential Maximum NPM Adjustment (2)	OPM's Potential Maximum NPM Adjustment (2)	SPM's Applicable Portion (3)	Total SPM's Credit (4)	Total Annual and Strategic Credit	Estimated Credit Attributable to Strategic Contribution Payments (5)	Estimated Credit Attributable to Annual Payments
2012	2017	$93,150,000	$54,162,327	$735,136,711	7.368%	$6,862,969	$100,012,969	$4,888,480	$95,124,490
2013	2018	96,410,250	49,409,268	764,784,562	6.461%	6,228,630	102,638,880	5,021,528	97,617,352
2014	2019	99,784,609	52,023,804	763,556,811	6.813%	6,798,675	106,583,284	5,212,598	101,370,686

(1) OPMs are allotted a credit equal to 60 cents per pack based on 150 million Tribal NPM Packs adjusted annually with interest at the Prime Rate (assumed to be 3.50%). 150 million Tribal NPM Packs is stipulated in the NY NPM Settlement for the sole purpose, according to the NY NPM Settlement, of calculating 2011 to 2014 Tribal NPM Packs Credits and does not constitute an admission by any party that 150 million was the actual volume of such sales.

(2) Source: NAAG.

(3) SPMs' Potential Maximum NPM Adjustment divided by OPMs' Potential Maximum NPM Adjustment.

(4) SPMs' Applicable Portion multiplied by the Total OPMs' Credit for that year.

(5) Based on Annual Payment and Strategic Contribution Payment Potential Maximum NPM Adjustment information adjusted for the State's applicable portion of each.

Table 3*
Projection of Variable Tribal NPM Packs Credits Against State Annual Payments
(Relating to Payment Year 2017 and Subsequent Years)

Sales Year	Payment Year	IHS Global Base Forecast of Tribal NPM Packs (1)	Tribal NPM Packs Credits Per Pack (2)	Total OPM's Credit	SPM's Potential Maximum NPM Adjustment (3)	OPM's Potential Maximum NPM Adjustment (3)	SPM's Applicable Portion (4)	Total SPM's Credit (5)	Total Annual Payments Credits (6)
2015	2017	54,238,554	$0.537	$29,109,832	$56,469,042	$833,699,411	6.773%	$1,971,699	$31,081,531
2016	2018	54,238,554	$0.553	29,983,127	56,469,042	833,699,411	6.773%	2,030,850	32,013,977
2017	2019	47,122,802	$0.499	23,496,513	56,469,042	833,699,411	6.773%	1,591,492	25,088,004
2018	2020	47,122,802	$0.514	24,201,409	56,469,042	833,699,411	6.773%	1,639,236	25,840,645
2019	2021	42,082,819	$0.529	22,261,353	56,469,042	833,699,411	6.773%	1,507,830	23,769,183
2020	2022	42,082,819	$0.545	22,929,194	56,469,042	833,699,411	6.773%	1,553,065	24,482,260
2021	2023	38,256,554	$0.561	21,469,754	56,469,042	833,699,411	6.773%	1,454,213	22,923,967
2022	2024	38,256,554	$0.578	22,113,845	56,469,042	833,699,411	6.773%	1,497,839	23,611,684
2023	2025	35,564,718	$0.595	21,174,589	56,469,042	833,699,411	6.773%	1,434,220	22,608,810
2024	2026	35,564,718	$0.613	21,809,828	56,469,042	833,699,411	6.773%	1,477,247	23,287,075
2025	2027	33,235,947	$0.632	20,993,177	56,469,042	833,699,411	6.773%	1,421,933	22,415,110
2026	2028	33,235,947	$0.651	21,622,972	56,469,042	833,699,411	6.773%	1,464,591	23,087,562
2027	2029	31,148,760	$0.670	20,873,021	56,469,042	833,699,411	6.773%	1,413,794	22,286,815
2028	2030	31,148,760	$0.690	21,499,210	56,469,042	833,699,411	6.773%	1,456,208	22,955,418
2029	2031	29,198,135	$0.711	20,757,456	56,469,042	833,699,411	6.773%	1,405,967	22,163,423
2030	2032	29,198,135	$0.732	21,380,179	56,469,042	833,699,411	6.773%	1,448,146	22,828,325
2031	2033	27,363,970	$0.754	20,638,235	56,469,042	833,699,411	6.773%	1,397,892	22,036,126
2032	2034	27,363,970	$0.777	21,257,383	56,469,042	833,699,411	6.773%	1,439,828	22,697,211
2033	2035	25,632,057	$0.800	20,509,324	56,469,042	833,699,411	6.773%	1,389,160	21,898,484
2034	2036	25,632,057	$0.824	21,124,604	56,469,042	833,699,411	6.773%	1,430,835	22,555,439
2035	2037	23,992,171	$0.849	20,366,289	56,469,042	833,699,411	6.773%	1,379,472	21,745,761
2036	2038	23,992,171	$0.874	20,977,276	56,469,042	833,699,411	6.773%	1,420,856	22,398,132
2037	2039	22,447,530	$0.901	20,215,541	56,469,042	833,699,411	6.773%	1,369,261	21,584,802
2038	2040	22,447,530	$0.928	20,822,006	56,469,042	833,699,411	6.773%	1,410,339	22,232,345
2039	2041	20,984,919	$0.955	20,049,269	56,469,042	833,699,411	6.773%	1,357,999	21,407,268
2040	2042	20,984,919	$0.984	20,650,747	56,469,042	833,699,411	6.773%	1,398,739	22,049,486
2041	2043	19,607,444	$1.014	19,874,062	56,469,042	833,699,411	6.773%	1,346,132	21,220,194
2042	2044	19,607,444	$1.044	20,470,283	56,469,042	833,699,411	6.773%	1,386,516	21,856,799
2043	2045	18,310,575	$1.075	19,689,836	56,469,042	833,699,411	6.773%	1,333,654	21,023,489
2044	2046	18,310,575	$1.108	20,280,531	56,469,042	833,699,411	6.773%	1,373,663	21,654,194
2045	2047	17,091,407	$1.141	19,498,105	56,469,042	833,699,411	6.773%	1,320,667	20,818,772
2046	2048	17,091,407	$1.175	20,083,048	56,469,042	833,699,411	6.773%	1,360,287	21,443,335
2047	2049	15,974,242	$1.210	19,333,447	56,469,042	833,699,411	6.773%	1,309,514	20,642,961
2048	2050	15,974,242	$1.247	19,913,451	56,469,042	833,699,411	6.773%	1,348,800	21,262,250
2049	2051	14,935,299	$1.284	19,176,855	56,469,042	833,699,411	6.773%	1,298,908	20,475,763
2050	2052	14,935,299	$1.323	19,752,161	56,469,042	833,699,411	6.773%	1,337,875	21,090,037

* Preliminary, subject to change.
(1) IHS Global's forecast is adjusted to reflect that a determination of Tribal NPM Packs is made by the Investigator in two year determination cycles.
(2) If volume of Tribal NPM Packs in the year at issue is less than 50 million, 47 cents for each such Tribal NPM Pack adjusted in accordance with the inflation adjustment in the MSA (calculation assumes 3.0% annual inflation adjustment floor).
(3) Source: NAAG.
(4) SPMs' Potential Maximum NPM Adjustment divided by OPMs' Potential Maximum NPM Adjustment.
(5) SPMs' Applicable Portion multiplied by the Total OPMs' Credit for that year.
(6) Assumes 100% of credits are attributable to Annual Payments.

Bond Structuring Assumptions

Delivery Date

The Series 2017 Bonds are assumed to be delivered on _____ __, 2016.

Issue Size

The objective in issuing the Series 2017 Bonds is to provide proceeds in an amount, together with amounts released from the Liquidity Reserve Account for the Refunded Bonds, and other funds held for the Refunded Bonds to: (1) establish an irrevocable escrow to refund the Refunded Bonds; (2) fund the deposit to the Senior Liquidity Reserve Account; (3) fund the deposit to the Subordinate Liquidity Reserve Account; and (4) pay the costs of issuance for the Series 2017 Bonds.

Maturities

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

Mandatory Redemption

All mandatory redemptions are assumed to be made in accordance with the Indenture and the Series 2017 Bonds, including, with respect to the Series 2017A Senior Bonds that are Term Bonds, redemption from Mandatory Sinking Fund Installments, and, with respect to the Series 2017B Subordinate Bonds, Turbo Redemptions, to the extent of Turbo Available Collections, and Mandatory Clean-Up Call of Subordinate Bonds, if applicable. The schedules of Mandatory Sinking Fund Installment payments dates, in the case of the Series 2017A Senior Bonds that are Term Bonds, are set forth in "THE SERIES 2017 BONDS — Redemption Provisions — Mandatory Redemption of Series 2017A Senior Bonds from Mandatory Sinking Fund Installments".

Interest Rates

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

Liquidity Reserve Accounts

The Senior Liquidity Reserve Requirement is $45,939,652.78.*

The Subordinate Liquidity Reserve Requirement is $20,546,666.67.*

Operating Expense and Tax Obligation Assumptions

Annual operating expenses of TSASC equal to the Operating Cap relating to Fiscal Years 2017 and 2018 are deposited to the Operating Account from Pledged TSRs received in April 2017. For each of the following years, operating expenses are assumed to equal the Operating Cap for the immediately following Fiscal Year. No Tax Obligations are assumed to be paid since it has been assumed that the yield on the invested bond proceeds of the Series 2017 Bonds will not exceed the arbitrage yield on the Series 2017 Bonds.

Interest Earnings and Release of Funds from Liquidity Reserve Accounts

It is assumed the amount on deposit in the Senior Liquidity Reserve Account equals the Senior Liquidity Reserve Requirement and is invested at annual rates from 0.03% per annum for the first year to 1.25% per annum in the sixth year and remain constant thereafter.

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* Preliminary, subject to change.

It is assumed the amount on deposit in the Subordinate Liquidity Reserve Account equals the Subordinate Liquidity Reserve Requirement and is invested at annual rates from 0.03% per annum for the first year to 1.25% per annum in the sixth year and remain constant thereafter.

Amounts in all other Accounts under the Indenture are assumed to be invested at a rate of 0.00% per annum. No interest earnings have been assumed on the Annual Payments prior to the time it is assumed they will be received by the Indenture Trustee.

Miscellaneous

The Pledged TSRs Projection Methodology and Assumptions assume that there is no optional redemption of the Series 2017 Bonds, that no Event of Default occurs, and that no PM makes a Lump Sum Payment or Total Lump Sum Payment under the MSA.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA and related information. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA 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. The State (and not TSASC) is a party to the MSA, and the summary of the MSA included herein has not been approved by the Attorney General of the State.

General

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

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the original OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to NAAG, the following PMs are parties to the MSA:

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OPMs	SPMs	
Philip Morris USA Inc. (formerly Philip Morris Incorporated)	Bekenton, S.A.*	Liggett Group, LLC
R.J. Reynolds Tobacco Company (formerly R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation (2004 merger) and Lorillard Tobacco Company (2015 merger))	Canary Islands Cigar Co.	Mac Baren Tobacco Company A/S
	Caribbean-American Tobacco Corp. (CATCORP)	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
	The Chancellor Tobacco Company, UK Ltd.	NASCO Products, LLC
	Commonwealth Brands, Inc.	OOO Tabaksfacrik Reemtsma Wolga (Russia)
	Daughters & Ryan, Inc.	P.T. Djarum
	M/s. Dhanraj International*	Pacific Stanford Manufacturing Corporation
	Eastern Company S.A.E.	Peter Stokkebye Tobaksfabrik A/S
	Ets L Lacroix Fils NV S.A. (Belgium)	Planta Tabak-manufaktur Gmbh & Co.
	Farmer's Tobacco Co. of Cynthiana, Inc.	Poschl Tabak GmbH & Co. KG
	General Jack's Incorporated	Premier Manufacturing Incorporated
	General Tobacco (VIBO Corporation d/b/a General Tobacco)**	Reemtsma Cigarettenfacbriken GmbH (Reemtsma)
	House of Prince A/S	Santa Fe Natural Tobacco Company, Inc.
	Imperial Tobacco Limited/ITL (USA) Limited	Scandinavian Tobacco Group Lane Ltd. (formerly Lane Limited and Tobacco Exporters International (USA) Ltd.)
	Imperial Tobacco Limited/ITL (UK)	Sherman's 1400 Broadway N.Y.C. Inc.
	Imperial Tobacco Mullingar (Ireland)	Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	Imperial Tobacco Polska S.A. (Poland)	Tabacalera del Este, S.A. (TABESA)
	Imperial Tobacco Production Ukraine	Top Tobacco, LP
	Imperial Tobacco Sigara ve Tutunculuk Sanayi Ve Ticaret S.A. (Turkey)	U.S. Flue-Cured Tobacco Growers, Inc.
	International Tobacco Group (Las Vegas), Inc.	Van Nelle Tabak Nederland B.V. (Netherlands)
	ITG Brands, LLC (formerly known as Lignum-2, LLC)†	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)
	Liberty Brands, LLC*	ZNF International, LLC

The MSA restricts PMs from transferring their tobacco product brands, cigarette product formulas and cigarette businesses (unless they are being transferred exclusively for use outside the United States) to any entity that is not a PM under the MSA, unless the transferee agrees to assume the obligations of the transferring PM under the MSA related to such brands, formulas or businesses. The MSA expressly provides that the payment obligations of each PM are not the obligation or responsibility of any affiliate of such PM and, further, that the remedies, penalties or sanctions that may be imposed or assessed in connection with a breach or violation of the MSA will

* Has filed for bankruptcy relief. There may be other PMs that have filed for bankruptcy relief, of which TSASC is not aware.

** Ceased production of cigarettes and other tobacco products.

† OPM with respect to those cigarette brands purchased from Reynolds American and Lorillard, Inc.

only apply to the PMs and not against any other person or entity. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "–Subsequent Participating Manufacturers".

Scope of Release

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

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

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

This release is binding upon each Settling State and any of its past, present and future agents, and officers acting in their official capacities, legal representatives, agencies, departments, commissions and divisions. The MSA is further stated to be binding on the following persons, to the full extent of the power of the signatories to the MSA to release past, present and future claims on their behalf: (i) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (ii) persons or entities acting in a *parens patriae*, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in the MSA (a) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of such Settling State, as opposed solely to private or individual relief for separate and distinct injuries, or (b) to the extent that any such entity (as opposed to an individual) is seeking recovery of healthcare expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State. All such persons or entities are referred to collectively in the MSA as "**Releasing Parties**".

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

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

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.* See "–Initial Payments" and "–Annual Payments". These payments (with the exception of the upfront Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "–Adjustments to Payments" and "–Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. The OPMs have made all of the Initial Payments. Thus far, most

* Under the Decree, Strategic Contribution Payments are retained by the State and no portion of such payments are allocable to the City and, therefore, are not included in Pledged TSRs available for payments of debt service by TSASC to the Bondholders. Other payments that are required to be made by the PMs, such as payments of attorneys' fees and payments to a national foundation established pursuant to the MSA, are not allocated to the Settling States and are not available to the Bondholders, and consequently are not discussed herein.

of the PMs* have made the Annual Payments due in 2000 through, and including, 2016 (subject to certain withholdings and payments into the Disputed Payments Account (the "**DPA**") under the MSA). See "—Payments Made to Date".

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

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

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base 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 Payment Account (also referred to herein as the "**DPA**"). Approximately $204 million, which was substantially all of the money previously deposited in the DPA for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.7 billion, was paid in December 2002 and January 2003, in the approximate amount of $2.14 billion after taking into account various adjustments. No Initial Payments were due after the 2003 Initial Payment.

Annual Payments

The OPMs and the other PMs are required to make Annual Payments on each April 15 in perpetuity. Most of the PMs made the Annual Payments due April 15 in each of the years 2000 through 2016. The scheduled base amounts of Annual Payments are set forth in the following table:

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

Base Amounts of Annual Payments[1]

Payment Year	Base Amount	Payment 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		

(1) The Annual Payments from 2000 through 2016 have been made. Adjustments to Annual Payments for a given year may impact Annual Payments due in subsequent years. This table reflects base amounts of Annual Payments only, and does not reflect adjustments. Actual payments received have been substantially lower than the base amounts due to the application of adjustments. See "—Payments Made to Date" below.

The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share (defined below) during the preceding calendar year. The base annual payments in the above table will be increased by at least the minimum 3% Inflation Adjustment, adjusted by the Volume Adjustment, reduced by the Previously Settled States Reduction, and further adjusted by the other adjustments described below. Each SPM has Annual Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share. However, any SPM that became a party to the MSA within 90 days after it became effective pays only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share (such higher share, the "**Base Share**").

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

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

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

Application of these adjustments resulted in a material reduction of the Annual Payments due to the State from the scheduled base amounts for the years 2000 through 2016, as discussed below under the caption "—Payments Made to Date".

Adjustments to Payments

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

Inflation Adjustment

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

Volume Adjustment

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

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

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

Certain PMs and Settling States were in dispute regarding whether the "roll-your-own" tobacco conversion of 0.0325 ounces for one individual cigarette should continue to be used for purposes of calculating the downward Volume Adjustments to the MSA payments (as Settling States contended), or, rather, a 0.09 ounce conversion (as PMs contended). Forty-three jurisdictions (including the State) entered into arbitration, and in an award dated January 21, 2013, the arbitration panel held that the MSA Auditor is to use the 0.0325 ounce conversion method for purposes of roll-your-own tobacco.

Previously Settled States Reduction

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

Non-Settling States Reduction

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

Non-Participating Manufacturers Adjustment

The "**NPM Adjustment**" under the MSA is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and operates to reduce the payments of the PMs under the MSA in the event that the PMs incur losses in market share to NPMs during a calendar year as a result of the MSA.

Currently, by virtue of the NY NPM Settlement entered into between PMs and the State in October 2015, the State is not subject to the NPM Adjustment as described in the MSA, but to an alternative adjustment under which the PMs will receive credits against their MSA payment obligations based on (i) the number of cigarettes manufactured by NPMs on which State cigarette excise tax is paid, but on which the escrow deposit required by the State's Qualifying Statute was not made (or if made was released other than as allowed by the Qualifying Statute) and (ii) the number of packs of NPMs cigarettes sold to non-Native American State consumers on, from, or through Native American reservations located in the State without payment of State cigarette excise taxes. See "NY NPM SETTLEMENT". However, under the terms of the NY NPM Settlement, the NPM Adjustment as described in the MSA will again be applicable to the State (with certain adjustments) if the number of NPM cigarettes on which the State collected excise tax but on which an escrow payment under the State's Qualifying Statute was not made exceeds an amount described in the NY NPM Settlement. See "NY NPM SETTLEMENT".

Twenty-four other jurisdictions entered into a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") (19 jurisdictions in December 2012, and 5 additional states in 2013 and 2014), pursuant to which those jurisdictions settled NPM Adjustment disputes regarding the 2003-2012 NPM Adjustments and modified the formula for the NPM Adjustments for 2013 and subsequent years applicable to those states. The State did not enter into the NPM Adjustment Settlement Term Sheet, and provisions of the NPM Adjustment Settlement Term Sheet are not described herein.

Under the MSA, three conditions must be met in order to trigger an NPM Adjustment; (1) the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997, (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question[*], and (3) the Settling States in question must be proven to not have diligently enforced their Model Statutes. The NPM Adjustment is applied to the subsequent year's Annual Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a Pro Rata basis among those Settling States that have been found (i) to not diligently enforce their Qualifying Statutes, or (ii) to have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "Base Aggregate Participating Manufacturer Market Share". If the PMs' actual aggregate market share is between 0% and 16 ⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16 ⅔%, the NPM Adjustment will be calculated as follows:

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

[*] The NY NPM Settlement provides that this significant factor condition shall no longer be operative as to the State and shall be deemed satisfied as to the State for each year.

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

The NPM Adjustment is also state-specific in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces the Model Statute or a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment for any given year will not exceed 65% of the amount of such state's allocated payment for the subsequent year. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts the Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See "RISK FACTORS—Payment Decreases Under the Terms of the MSA" and "—MSA Provisions Relating to Model/Qualifying Statutes". See also "—Most Favored Nation Provisions" and "NY NPM SETTLEMENT".

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

Litigating Releasing Parties Offset

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

Offset for Claims-Over

If a Releasing Party pursues and collects on a released claim against an NPM or a retailer, supplier or distributor arising from the sale or distribution of tobacco products of any NPM or the supply of component parts of tobacco products to any NPM (collectively, the "**Non-Released Parties**"), and the Non-Released Party in turn

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

Subsequent Participating Manufacturers

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

For each Annual Payment, each SPM is required to pay an amount equal to the base amount of the Annual Payment owed by the OPMs, collectively, adjusted for the Volume Adjustment described above but prior to any other adjustments, reductions or offsets, multiplied by (i) the difference between that SPM's Market Share for the preceding year and its Base Share, divided by (ii) the aggregate Market Share of the OPMs for the preceding year. Other than the application of the Volume Adjustment, payments by the SPMs are also subject to the same adjustments (including the Inflation Adjustment), reductions and offsets as are the payments made by the OPMs, with the exception of the Previously Settled States Reduction.

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

Certain PMs and Settling States were in dispute regarding whether the payment obligations of one SPM (Liggett Group LLC) should continue to be determined based on the "net" number of cigarettes on which federal excise tax is paid (as Settling States contended), or, rather, an "adjusted gross" number of cigarettes (as PMs contended). Forty-three jurisdictions (including the State) entered into arbitration, and in an award dated January 21, 2013, the arbitration panel held that the MSA Auditor is to use the market share for Liggett Group LLC on a net basis, but increase that calculation by a specified factor to avoid unfairness given the gross basis used for Liggett Group LLC in the MSA Auditor's March 30, 2000 calculation.

Payments Made to Date

As required, the OPMs have made all of the Initial Payments and most PMs have made Annual Payments since 2000, and the MSA Escrow Agent has disbursed to the City (and following the execution of the TSR Purchase Agreement, to TSASC) its allocable portions thereof and certain other amounts under the MSA. Under the MSA, the computation of Annual Payments by the MSA Auditor is confidential and may not be used for purposes other

than those stated in the MSA. The City's and TSASC's sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to them by the State.

The following table sets forth for each of the preceding 10 years the base amount of Annual Payments allocable to TSASC pursuant to the MSA and the Decree that have been pledged under the Indenture (due on April 15th of each year), and the amount of Pledged TSRs actually received by the Indenture Trustee (for each Fiscal Year ending June 30th). The amounts actually received by the Indenture Trustee may reflect adjustments attributable to prior years' payments.

Fiscal Year	Pledged Portion of Base Payment Allocable to TSASC[(1)(2)]	Indenture Trustee's Actual Receipts of Pledged TSRs[(1)(3)]
2007	$101,836,719	$ 77,953,795
2008	103,606,132	78,890,393
2009	103,606,132	86,996,961
2010	103,606,132	72,398,952
2011	103,606,132	68,640,155
2012	103,606,132	70,000,424
2013	103,606,132	69,956,949
2014	103,606,132	79,144,385
2015	103,606,132	67,728,992
2016	103,606,132	136,802,790

(1) Annual Payments are due from the PMs on April 15 of each calendar year pursuant to the MSA. The Indenture Trustee's actual receipts of Pledged TSRs are listed as of June 30 of each year (which is the end of TSASC's Fiscal Year).

(2) TSASC's allocable portion that has been pledged under the Indenture as represented in this table consists of the City's 26.670% share, pursuant to the Decree, of the State's 12.762031% share of Annual Payments under the MSA, multiplied by 37.40%, which is the percentage of Tobacco Assets that is pledged under the Indenture, constituting the Pledged TSRs.

(3) Reflects adjustments (including disputed amounts, together with interest thereon, released pursuant to the MSA). Any adjustment is reflected in the period in which it was actually received by the Indenture Trustee. Actual receipts in Fiscal Year 2016 include amounts released pursuant to the NY NPM Settlement.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the captions "–Annual Payments" and "–Adjustment to Payments". One or more of the PMs are disputing or have disputed the calculations of some of the Annual Payments for the years 2000 through 2016, as described further herein. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

Most Favored Nation Provisions

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

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

State-Specific Finality and Final Approval

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

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

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

Disbursement of Funds from Escrow

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

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

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of proofs-of-purchase coupons. The PMs are also prohibited from placing any new outdoor and transit advertising, and are committed to remove any existing outdoor and transit advertising for Tobacco Products in the Settling States. Other examples of prohibited activities include, subject to limited exceptions: (i) the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; (ii) the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; and (iii) the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages.

In addition, the OPMs have agreed under the MSA to provide funding for the organization and operation of a charitable foundation (the "**Foundation**") and educational programs to be operated within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. Each OPM may be required to pay its Relative Market Share of $300,000,000 on April 15 of each year on and after 2004 (as may be adjusted) in

perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the OPMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

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

Termination of MSA

The MSA is terminated as to a Settling State if (i) the MSA or consent decree in that jurisdiction is disapproved by a court and the time for an appeal has expired, the appeal is dismissed or the disapproval is affirmed, or (ii) the representations and warranties of the attorney general of that jurisdiction relating to the ability to release claims are breached or not effectively given. In addition, in the event that a PM enters bankruptcy and fails to perform its financial obligations under the MSA, the Settling States, by vote of at least 75% of the Settling States, both in terms of number and of entitlement to the proceeds of the MSA, may terminate certain financial obligations of that particular manufacturer under the MSA, although this provision may not be enforceable. See "LEGAL CONSIDERATIONS—Bankruptcy of a PM May Delay or Reduce Payments".

The MSA provides that if it is terminated, then the statute of limitations with respect to released claims will be tolled from the date the Settling State signed the MSA until the later of the time permitted by applicable law or one year from the date of termination and the parties will jointly move for the reinstatement of the claims and actions dismissed pursuant to the MSA. The parties will return to the positions they were in prior to the execution of the MSA.

Severability

By its terms, most of the major provisions of the MSA are not severable from its other terms. If a court materially modifies, renders unenforceable or finds unlawful any non-severable provision, the attorneys general of the Settling States and the OPMs are to attempt to negotiate substitute terms. If any OPM does not agree to the substitute terms, the MSA terminates in all Settling States affected by the court's ruling.

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

General

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

Settling States may eliminate or mitigate the effect of the NPM Adjustment by taking certain actions, including the adoption and diligent enforcement of a statute, law, regulation or rule (a "**Qualifying Statute**" or

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

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

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

For a discussion of the NY NPM Settlement, see "NY NPM SETTLEMENT".

Summary of the Model Statute

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

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

Accordingly, pursuant to the Model Statute, a tobacco manufacturer that is an NPM under the MSA must deposit an amount for each cigarette that constitutes a "unit sold" into an escrow account (which amount increases on a yearly basis, as set forth in the Model Statute). "Units sold" is defined in the State's Qualifying Statute as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp of the State, or on "roll-your-own" tobacco containers.

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

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

If the NPM fails to place funds into escrow as required by the applicable Qualifying Statute, the attorney general of the applicable Settling State may bring a civil action on behalf of the state against the NPM. If a court finds that an NPM violated the statute, it may impose civil penalties in the following amounts: (i) an amount not to exceed 5% of the amount improperly withheld from escrow per day of the violation and in an amount not to exceed 100% of the original amount improperly withheld from escrow; (ii) in the event of a knowing violation, an amount not to exceed 15% of the amount improperly withheld from escrow per day of the violation and in an amount not to exceed 300% of the original amount improperly withheld from escrow; and (iii) in the event of a second knowing violation, the court may prohibit the NPM from selling cigarettes to consumers within such state (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed two years.

NPMs include Native American tobacco manufacturers, several of which are located in the State, that manufacture and sell, directly or through other Native American retailers, cigarettes to consumers from their own or other Native American reservations and who assert their rights under various treaties and agreements with the United States and with states, including the State, to manufacture and sell the cigarettes free of state and local taxes and, generally, free from the constraints and burdens of state and local laws, such as the State's Qualifying Statute. See "NY NPM SETTLEMENT" and "CERTAIN FACTORS AFFECTING TRIBAL NPM SALES."

NPMs also 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

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

States may be difficult. See "RISK FACTORS—If Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation Were Successful, Payments under the MSA Might be Suspended or Terminated".

STATE LAWS RELATED TO MSA

State Statutory Framework

The State in 1999 enacted a Qualifying Statute, codified as Article 13-G of the Public Health Law, which counsel to the OPMs had confirmed the OPMs would not dispute as constituting a Model Statute under the MSA. In 2003, the State enacted an Allocable Share Release Amendment to amend the State's Qualifying Statute by eliminating the provision authorizing an NPM to obtain the release of the amount by which its annual escrow deposit exceeds 12.7620310% of the total payments that the NPM would have made as a PM for that year. Under the State's Allocable Share Release Amendment, an NPM is entitled to the release of its escrow deposit only to the extent that the deposit exceeded the total amount that the NPM would have paid as a PM. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes–*Summary of the Model Statute*".

Pursuant to the provisions of State Tax Law Sections 480-b (relating to manufactured cigarettes), 480-c (relating to roll-your-own tobacco), 481(1)(c)&(d), 1846(a-1) and 1846-a(a-1) (collectively, the State's "**Complementary Legislation**"), tobacco product manufacturers whose cigarettes or roll-your-own tobacco products are sold in the State are required to annually certify that either (i) they are PMs that have complied with requirements of the MSA or (ii) they have complied with the State's Qualifying Statute requirement to deposit money in a qualified escrow fund. No cigarette tax stamps may be affixed to the manufactured 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.

While these provisions of State law apply to all tobacco product manufacturers in the State, they are not currently being enforced against Native American tobacco product manufacturers located on reservations in the State who sell their products through outlets located on Native American reservations within the State without payment of State cigarette tax. These untaxed reservation sales, as estimated pursuant to the NY NPM Settlement, result in a reduction in Annual Payments to the State under the MSA. See "NY NPM SETTLEMENT" and "CERTAIN FACTORS AFFECTING TRIBAL NPM SALES."

State Enforcement Agencies

The following information under this subheading "State Enforcement Agencies" appeared in the Official Statement, dated December 5, 2013, of the Tobacco Settlement Financing Corporation, a public benefit corporation of the State established as a subsidiary of the State of New York Municipal Bond Bank Agency. Although TSASC has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, TSASC has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. Further, neither the State nor the Tobacco Settlement Financing Corporation is making any representation that such information is accurate or complete in connection with TSASC's issuance and sale of the Series 2017 Bonds. TSASC's Series 2017 Bonds are not a debt of the State or the Tobacco Settlement Financing Corporation.

Attorney General Tobacco Compliance Bureau

The Tobacco Compliance Bureau of the Office of the New York Attorney General (the "**Bureau**") is responsible for enforcing the MSA, maintaining files of compliant NPMs by manufacturer and brand-name, and for receiving and approving the annual compliance certifications from PMs and NPMs. Senior officers or directors of the tobacco products manufacturers must file with the Bureau, under penalty of perjury, annual certifications of compliance. New York State licensed cigarette stamping agents must file with the State Tax Dept. a monthly report of all sales of cigarettes, including the NPM brands, and such sales must bear New York cigarette tax stamps. Tobacco products distributors that are appointed to pay the tobacco products tax must file monthly reports for sales

of roll-your-own. Cigarette and roll-your-own brands and manufacturers that are not properly certified and, in the case of cigarettes, do not bear New York cigarette tax stamps, may not be sold in New York. The State's Qualifying Statute provides an automatic statutory enforcement mechanism that complements the Model Statute and which allows the State to immediately ban the stamping and selling of cigarettes from non-compliant NPMs without the delay of waiting for two known violations and then obtaining a judgment. Consequently, litigation is not necessary to enforce NPM escrow compliance.

The Bureau and its predecessor units have been responsible since inception for pursuing non-compliant NPMs. The Qualifying Statute requires that an NPM deposit funds into an escrow account for the benefit of New York for all "units sold" in the State during the preceding year. As noted above, a "unit sold" is defined as a cigarette upon which State excise tax has been paid and which bears the State's excise tax stamp.

The Bureau also has taken action against PMs who have not complied with their MSA payment obligations or to remedy violations of other provisions of the MSA. In 2006, the Bureau joined with other Settling States in reaching a settlement with a PM (House of Prince) for selling cigarettes in the State and other states without making MSA payments and obtained a $55.4 million settlement, including $6,486,510.53 for the State of New York. Two states have filed suit seeking full payment by General Tobacco (VIBO Corp. d/b/a General Tobacco) of its MSA payment obligations. Such actions will benefit all Settling States, including the State, if payments are ordered and made. General Tobacco is no longer certified to sell cigarettes in the State. The Bureau also has participated actively in various multi-state initiatives against certain OPMs to enforce the advertising and promotion restrictions in the MSA.

Department of Taxation and Finance Enforcement Actions

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

Department of Taxation and Finance Transaction Desk Audit Bureau Actions

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

NY NPM SETTLEMENT

The following is a brief summary of certain provisions of the NY NPM Settlement and related information. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the NY NPM Settlement which is attached hereto as APPENDIX D. The State (and not TSASC) is a party to the NY NPM Settlement, and the summary of the NY NPM Settlement included herein has not been approved by the Attorney General of the State.

General

The State, OPMs Philip Morris and Reynolds Tobacco, and 32 of the 52 SPMs listed by NAAG (such 32 SPMs being referred to herein as the "**Settlement Agreement SPMs**" or "**SA SPMs**" and, together with the OPMs, the "**Settlement Agreement PMs**" or "**SA PMs**") have entered into a settlement agreement, effective October 16, 2015, to resolve then current and potential future claims related to the NPM Adjustment under the MSA as applied to the State (the "**NY NPM Settlement**"). A copy of the NY NPM Settlement is attached as APPENDIX D. More specifically, the NY NPM Settlement (i) resolves all claims by the SA PMs that they are each entitled to an NPM Adjustment in their payment obligations to the State under the MSA for sales years 2004 through 2014 and (ii)

establishes a new set of potential future adjustments for sales years 2015 and later in lieu of the NPM Adjustment. According to the State's Attorney General's office, the SA PMs include all the SPMs who had asserted an NPM Adjustment claim against the State.

The MSA provides that it can be amended only with the consent of the parties affected by the amendment. No assurance can be given that the NY NPM Settlement does not constitute an amendment of the MSA or that the NY NPM Settlement does not have an effect on parties that are not signatories to the NY NPM Settlement. If it were to be determined that the NY NPM Settlement does have an effect on parties that are not signatories, then all or part of the NY NPM Settlement may be unenforceable.

The SA PMs are listed below:

Philip Morris USA Inc. (formerly Philip Morris Incorporated)
R.J. Reynolds Tobacco Company (formerly R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation and Lorillard Tobacco Company)
Commonwealth Brands, Inc.
Daughters & Ryan, Inc.
Ets L Lacroix Fils NV S.A. (Belgium)
Farmer's Tobacco Co. of Cynthiana, Inc.
House of Prince A/S
Imperial Tobacco Limited/ITL (UK)
Imperial Tobacco Mullingar (Ireland)
Imperial Tobacco Polska S.A. (Poland)
Imperial Tobacco Production Ukraine
Imperial Tobacco Sigara ve Tutunculuk Sanayi Ve Ticaret S.A. (Turkey)
ITG Brands, LLC (formerly known as Lignum-2, LLC)
Japan Tobacco International USA, Inc.
King Maker Marketing
Kretek International
Liggett Group, LLC
Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
OOO Tabaksfacrik Reemtsma Wolga (Russia)
P.T. Djarum
Peter Stokkebye Tobaksfabrik A/S
Premier Manufacturing Incorporated
Reemtsma Cigarettenfacbriken GmbH (Reemtsma)
Santa Fe Natural Tobacco Company, Inc.
Scandinavian Tobacco Group Lane Ltd. (formerly Lane Limited and Tobacco Exporters International (USA) Ltd.)
Sherman's 1400 Broadway N.Y.C. Inc.
Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
Tabacalera del Este, S.A. (TABESA)
Top Tobacco, LP
U.S. Flue-Cured Tobacco Growers, Inc.
Van Nelle Tabak Nederland B.V. (Netherlands)
Vector Tobacco Inc.
Von Eicken Group
Wind River Tobacco Company, LLC

Settlement Terms Relating to Disputed Payments Account

Amounts Previously Deposited to DPA. The NY NPM Settlement provided for the release in April 2016 to the State from the Disputed Payment Account (the "**DPA**") under the MSA of the State's proportionate share of amounts, if any, deposited by the SA PMs for years 2004-2014 on the basis of their NPM Adjustment claims, plus the accumulated earnings on such amount to the time of release. The DPA deposits included amounts attributable to the SA PMs obligations to make Strategic Contribution Payments under MSA Section IX(c)(2), all of which payments are retained by the State.

According to the State Attorney General's office, the April 2016 Annual Payment and the amount of Annual Payment funds simultaneously released from the DPA to the State were as follows:

Distribution Components	Amounts Distributed
2016 Annual Payment to State	$ 711,003,882.38
NY NPM Settlement DPA Release	660,510,408.80
Total Distribution to State Annual Payment Distributees	**$1,371,514,291.18**

The DPA release to the State was net of credits under the NY NPM Settlement in favor of (i) the OPMs in the amount of $135,057,019.83 and (ii) the SA SPMs in the amount of $6,435,941.26.

The OPMs' credit was comprised of two components. First, each OPM was entitled to a one-time credit against its 2016 Annual Payment equal to 10% of the amounts it deposited into the DPA for years 2004-2010 relating to Annual Payments. Second, as described below, the OPMs collectively were entitled in April 2016 to a stipulated $90 million Tribal NPM Packs Credit. See "—Credit to Settlement Agreement PMs for Sales in the State of Certain NPM Cigarettes – Tribal NPM Packs Credit."

Each SA SPM was similarly entitled to a one-time credit against its April 2016 Annual Payment relating to the release of funds from the DPA to the State. This SA SPM credit is equal to the product of the aggregate of the OPMs' credits for years 2004-2010 multiplied by a fraction, the numerator of which is the SA SPM's "Potential Maximum NPM Adjustment" for 2004-2010 and the denominator of which is the OPMs' collective "Potential Maximum NPM Adjustment" for 2004-2010. (For the definition of "Potential Maximum NPM Adjustment" as applied to the OPMs collectively and to each SA SPM separately, see the copy of the NY NPM Settlement attached hereto as APPENDIX D.) Information with respect to the Potential Maximum NPM Adjustment amounts of the PMs is available on the NAAG website.

Amounts Not Yet Deposited to DPA. The NY NPM Settlement separately addresses claimed NPM Adjustment amounts for years, both prior and future, for which such amounts had not been deposited to the DPA as of NY NPM Settlement effective date – namely, (i) the 2013 and 2014 NPM Adjustments for the OPMs and two of the SA SPMs, Tabacalera del Este, S.A. ("**TABESA**") and U.S. Flue Cured Tobacco Growers, Inc. ("**U.S. Flue-Cured**") and (ii) the NPM Adjustments for subsequent years for all SA PMs. For the OPMs, TABESA and U.S. Flue-Cured, each is required to deposit into the DPA on April 15 of each year, beginning in 2016, the State's Allocable Share of such SA PM's Potential Maximum NPM Adjustment for the year preceding the year of payment by three years (for example, the 2016 deposit was for 2013), provided, however, that such deposits when made shall be immediately released to the State pursuant to instructions from each such SA PM and the State to the Independent Auditor. For the remaining SA SPMs, similar arrangements apply except that the Potential Maximum NPM Adjustment amounts due each April 15, beginning in 2016, that are to be deposited to and immediately released to the State from the DPA shall be for the immediately preceding year.

Credit to Settlement Agreement PMs for Sales in the State of Certain NPM Cigarettes

The NY NPM Settlement provides for two credits against the SA PMs' payment obligations under the MSA related to annual sales of NPM cigarettes in the State beginning in 2015: the Tribal NPM Packs Credit and the Non-Compliant SET-Paid NPM Sales Credit (each of which is described below). The two credits are separately calculated and are not in any way linked.

Tribal NPM Packs Credit

General. One credit under the NY NPM Settlement, referred to herein as the "**Tribal NPM Packs Credit,**" relates to NPM cigarettes sold to State non-tribal consumers without payment of the State's cigarette excise tax ("**SET**") that (i) are sold, shipped or distributed, directly or indirectly on or through Native American reservations located in the State, including where the NPM cigarettes are sold, shipped, distributed or routed through such a reservation for sale to consumers elsewhere, (ii) are manufactured, sold, shipped or distributed by a person or entity having or claiming status as, ownership by, membership in or other affiliation with a State Native American tribe or one or more members thereof, or (iii) have any association with a State Native American tribe or a State Native American that forms any part of the reason why the State did not collect SET on the NPM cigarettes. Packs of such NPM cigarettes are referred to herein as "**Tribal NPM Packs**".

The NY NPM Settlement states that (a) "a Native American reservation located in New York includes any area within the geographic boundaries of the State of New York that is recognized as a tribal reservation, tribal land, qualified reservation, Indian country or Indian trust land by federal law, New York law or both" and (b) a State "Native American tribe includes Cayuga Nation, Oneida Nation of New York, Onondaga Nation, Poospatuck or Unkechauge Nation, St. Regis Mohawk Tribe, Seneca Nation of Indians, Shinnecock Indian Nation, Tonowanda Band of Seneca, Tuscarora Nation and any other tribe or Indian nation that has a Native American reservation located in New York or that is recognized as a Native American tribe or Indian Nation located in New York by federal law, New York law or both."

Background Information. For discussions of the history of tribal cigarette sales in the State and federal law applicable to the State's ability to tax cigarettes sold by Native Americans from tribal lands, see "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES—History of State Taxation of Cigarette Sales on Native American Reservations" and "—Legal Considerations Relating to Collection of State Cigarette Tax on Tribal Sales."

There are eight areas in the State that contain tracts of land owned by the U.S. government as Native American reservations or as non-reservation Native American lands held in trust for a recognized tribe by the U.S. government. Three of these areas are reservations of the Seneca Nation of Indians, and the other areas are reservations or trust lands of, respectively, the Oneida Nation of New York, the Onondaga Nation, the Akwesasne (a/k/a the St. Regis Mohawk), the Tonawanda Band of Senecas, and the Tuscarora Nation.

The federal reservations vary greatly in size. According to U.S. Census Bureau data, the two largest are the Seneca Nation of Indians' Alleghany and Cattaraugus Reservations, which the U.S. Census Bureau lists at 40.89 acres and 33.55 acres, respectively. The third Seneca Nation reservation, Oil Springs, is approximately one square mile in area. In order of size, the next four largest reservations, according to the U.S. Census Bureau, are St. Regis Mohawk (18.94 sq. miles), Tonawanda Band of Senecas (11.8 sq. miles), Onondaga Nation (9.25 sq. miles), and Tuscarora (9.08 sq. miles). With the exceptions of the Onondaga Nation reservation in central New York and the St. Regis Mohawk reservation in the northern part of the State bordering the St. Lawrence River and Canada, all of the federal reservations are in Western New York.

The Oneida Nation federal "reservation" identified by the U.S. Census Bureau is an area of less than one-tenth of an acre in Madison County in central New York. However, there are over 13,000 acres (over 20 sq. miles), representing the aggregate area of hundreds of parcels in Oneida and Madison Counties that have been acquired by the Oneida Nation and accepted as Indian trust land by the U.S. These are described in the Oneida Nation Agreement. That agreement recognizes that such approximately 13,000 acres, plus an additional area of approximately 12,000 acres in Oneida and Madison Counties reacquired by the Oneida Nation, shall be exempt from State and local property taxation, and shall be treated as "Oneida Nation Land" from which sales of cigarettes can be made exempt from the SET, but subject to an equivalent Oneida Nation cigarette tax. See "CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES—Oneida Nation Agreement."

Neither the Shinnecock Indian Nation, the Unkechaug (a/k/a the Poospatuck Indians), nor the Cayuga Nation have a federal reservation, although both the Shinnecock Indian Nation and the Unkechaug have small reservations (1.35 sq. miles and 0.11 sq. miles, respectively) in Suffolk County on Long Island recognized by the State. The Shinnecock Indian Nation is a federally recognized tribe and its reservation has been accepted by the U.S. as Indian trust land. The Unkechaug are not currently a federally recognized tribe.

The Cayuga Nation currently has no land held in trust for it as a reservation by either the State or the U.S. However, the State's highest court, the Court of Appeals, determined in a 2010 decision that Cayuga Nation members can sell untaxed cigarettes from two venues they own, one in the Village of Union Springs in Cayuga County, and one in the hamlet of Seneca Falls in Seneca County. Both sites are in parts of the approximately 64,000-acre area around Cayuga Lake, part in Seneca County and part in Cayuga County, that was set aside as a reservation for the Cayuga Indians under a 1794 federal treaty, but later conveyed to the State and others in transactions that were not approved by the federal government as required by applicable federal law. *Cayuga Indian Nation of New York v. Gould*. The Cayuga Nation is also reported to have applications pending before the U.S. Bureau of Indian Affairs ("**BIA**") to have approximately 125 acres of its historic reservation accepted by the BIA as Indian trust lands.

The table below lists the counties in which the Native American lands described above are located, as well as the estimated number of cigarette outlets on each reservation based on information available from on-line mapping services and websites of individual establishments:

Tribe or Nation	Federally Recognized	Reservation and/or Other Property	Location by County of Reservation or Other Property	Estimated Cigarette Outlets
Seneca Nation of Indians	Yes	Allegany Res.	Cattaraugus	18
		Cattaraugus Res.	Erie, Cattaraugus & Chautauqua	11
		Oil Springs Res.	Alleghany & Cattaraugus	2
Cayuga Nation	Yes	Other Property	Cayuga & Seneca[4]	2
Oneida Nation of New York	Yes	Oneida Res. and Other Property	Madison & Oneida	18
Onondaga Nation	Yes	Onondaga Res.	Onondaga	1
Unkechaug Nation	No	Poospatuck Res. (State)	Suffolk	6
Shinnecock Indian Nation	Yes	Shinnecock Res.	Suffolk	6-9
Akwesasne	Yes	St. Regis Mohawk	Franklin	18-22
Tonawanda Band of Senecas	Yes	Tonawanda	Erie, Genesee & Niagara	8-12
Tuscarora Nation	Yes	Tuscarora	Niagara	4-6

Fixed Tribal NPM Packs Credits. The Tribal NPM Packs Credit for years 2011-2014 is stipulated by the parties to the NY NPM Settlement to be $90 million a year for the OPMs, plus a credit for each SA SPM equal to the $90 million multiplied by a fraction, the numerator of which is the SA SPM's "Potential Maximum NPM Adjustment" for the year, and denominator of which is the OPMs' aggregate "Potential Maximum NPM Adjustment" for the year (as such quoted terms are defined in the NY NPM Settlement), plus interest at the Prime Rate added from April 15, 2016 on credits to be taken in 2017-2019. The credits for 2011-2014 are referred to herein as "**Fixed Tribal NPM Packs Credits**". The Fixed Tribal NPM Packs Credit for 2011 was part of the aggregate $135,057,019.83 taken as credits against the April 2016 payment to the State discussed above. The NY NPM Settlement states that the $90 million per year Fixed Tribal NPM Packs Credit for 2011-2014 is based on stipulated sales of 150 million Tribal NPM Packs a year, which the NY NPM Settlement states does not constitute an admission by either the State or the SA PMs that 150 million was the actual volume of NPM Tribal Packs sales. Neither the Native American manufacturers of cigarettes located in the State nor the Native American sellers of Native American-made cigarettes located in the State (excepting only the Oneida Nation cigarette sellers) report publicly or to the State any information regarding the quantities of untaxed Native American-made NPM cigarettes they manufacture or sell. IHS Global in the IHS Global Tribal Sales Report estimates Tribal NPM Packs sold in the State in 2015 at approximately 54.2 million packs and in 2016 at approximately 49.8 million packs. See "IHS GLOBAL TRIBAL SALES REPORT" and APPENDIX A-2—"IHS GLOBAL TRIBAL SALES REPORT."

Variable Tribal NPM Packs Credits. For years after 2014, the Tribal NPM Packs Credit under the NY NPM Settlement is referred to herein as the "**Variable Tribal NPM Packs Credit**." The Variable Tribal NPM Packs Credit for the OPMs is based on an estimate of the annual amount of Tribal NPM Packs sales as determined by an investigator (the "**Investigator**") to be agreed upon by the SA PMs and the State (or, failing agreement on the selection of the Investigator, by the International Institute for Conflict Prevention & Resolution ("**CPR**") of New York, New York, or CPR's successor), multiplied by the following per pack amounts, which, beginning with the Tribal NPM Packs Credit for sales year 2015 (to be taken against the Annual Payments due in 2017), shall be subject to adjustment in accordance with the inflation adjustment of the MSA (with 2015 as the base year):

Volume of Tribal NPM Packs Sold in the Year (in millions)	Per Pack Credit Without Inflation Adjustment (in cents)
125 or more	70
100 or more, but less than 125	67
75 or more, but less than 100	60.33
50 or more, but less than 75	53.67
Less than 50	47

In all cases, the per pack credit associated with a particular estimated annual volume level as determined by the Investigator will apply to all of the estimated Tribal NPM Packs for the year. Thus, for example, if the Investigator were to estimate annual Tribal NPM Packs sales of 85 million, the credit would equal the product of 85 million multiplied by 60.33 cents multiplied by the applicable inflation adjustment, and if the Investigator were to estimate annual Tribal NPM Packs sales of 65 million, the credit would equal the product of 65 million multiplied by 53.67 cents multiplied by the applicable inflation adjustment.

The State Attorney General's office has not announced the selection of an Investigator.

For each SA SPM, the Variable Tribal Packs Credit for each of years 2015 and later is equal to the aggregate OPMs' Variable Tribal Packs credit for the year multiplied by a fraction, the numerator of which is the SA SPM's Potential Maximum NPM Adjustment under the MSA for the year, and the denominator of which is the aggregate OPMs' Potential Maximum NPM Adjustment for the year.

The Variable Tribal Packs Credit for 2015 and any later year shall be applied to the SA PMs' payments pursuant to the MSA due on the April 15 during the calendar year two years following the year for which the payment is calculated. For example, the Variable Tribal Packs Credit for 2015 shall be applied to the MSA payments due on April 15, 2017.

Thus, under the terms of the NY NPM Settlement, for a three-year period, 2017 through 2019, the SA PMs will be entitled to reduce their Annual Payments by both Fixed Tribal NPM Packs Credits for years 2012 through 2014 and Variable Tribal NPM Packs Credits for years 2015 through 2017 as shown in the table below. (Starting in payment year 2020, only the Variable Tribal NPM Packs Credit will apply.) The estimated Fixed Tribal Packs Credits attributable to Annual Payments to the State for each of 2012 through 2014, which will be taken in sales years 2017 through 2019, are expected to be approximately as set forth in the table below, assuming interest from April 15, 2016 at 3.5% per year and based on the stipulation in the NY NPM Settlement described above, and the Variable Tribal Packs Credits for sales years 2015 through 2017, which will be taken in sales years 2017 through 2019, have been estimated, based on IHS Global Tribal Sales Report projection (base case) of Tribal NPM Packs sales for 2015 and later years, to be approximately as set forth in the table below. See "IHS GLOBAL TRIBAL SALES REPORT" and "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS". However, the actual Variable Tribal Packs Credit for sales years 2015 and later will be based on the determination of the Investigator, and there can be no assurance the Investigator's estimates will not be materially higher than IHS Global's estimate, which would result in a higher credit in favor of the SA PMs, and a reduction in Annual Payments to TSASC.

	Year Annual Payment Due		
	2017	**2018**	**2019**
Projected Fixed Tribal NPM Packs Credit	$95.1 million	$97.6 million	$101.4 million
(Year for which the Tribal NPM Packs Credit may be taken is shown in parentheses)	*(2012)*	*(2013)*	*(2014)*
Projected Variable Tribal NPM Packs Credit	$31.1 million	$32.0 million	$25.1 million
(Year for which the Tribal NPM Packs Credit may be taken is shown in parentheses)	*(2015)*	*(2016)*	*(2017)*

The NY NPM Settlement states that determinations by the Investigator of the number of Tribal NPM Packs shall be conclusive, final and binding on all parties and no appeal, request for vacatur or modification or other challenge to the determinations shall be permitted (although, if either the State or the PMs (as a side) fails to provide material information that it was required to provide, the other side may request the Investigator to reopen and revise its findings for a year).

The parties to the NY NPM Settlement shall select an Investigator once every four years (except as the parties otherwise agree or if there is good cause shown to terminate an Investigator's term early based on actions that fall outside accepted professional practice). An Investigator will make two determinations during its four-year term, each determination to apply for two years (meaning, for example, that the Investigator's determination of the 2015 volume of Tribal NPM Packs shall be deemed the volume for 2016 as well).

Except as described in the second succeeding paragraph, by April 15 of the year following the year for which the Investigator is to make a determination of Tribal NPM Packs, each of the State on the one hand and the SA PMs having more than one percent Market Share (as defined in the MSA) on the other (each a side) will provide to the other side all information in its possession or control that it will submit to the Investigator within the next 45 days, and each side has 30 days to respond to the other side's submission. The submissions and responses of each side may include whatever the side believes will be helpful to the Investigator (provided that the submissions and responses by a side shall not include or rely on any information which the side was required to provide to the other side prior to April 15 as described above). In the event a side includes or relies on information in violation of the restriction described in the preceding sentence or provides additional information within ten days prior to the due date for responses, the other side may make a further submission addressing the additional information within 30 days of its receipt.

The NY NPM Settlement provides that (a) the Investigator shall conduct its investigation in accordance with accepted professional practice and, in so doing, will have full discretion to consider the State's and the SA PMs' submissions and responses, to conduct independent research and investigate activities, and to make requests of the parties, (b) the Investigator's findings are due within 120 days of the parties' initial submissions, unless the parties agree to extend that period, (c) the findings shall consist of the Investigator's best professional estimate, based on its investigation, of the number of Tribal NPM Packs in the prior year, along with an explanation of its findings, and (d) the Investigator's findings shall be confidential and shall not be used for any purpose other than implementation of the NY NPM Settlement. The NY NPM Settlement provides that the parties' initial submissions to the Investigator are due no later than May 31 in the year after the year for which the determination is being made. Hence, the Investigator's determination is due by the end of September absent an extension agreed to by the parties.

The State Attorney General's office has reported that the deadlines described in the preceding two paragraphs have been extended for the initial determination of NPM Tribal Packs (for sales years 2015 and 2016). However, the new deadlines have not been announced.

In the NY NPM Settlement, the SA PMs release and discharge the State from any claims by the SA PMs based on or arising under or related to the NPM Adjustment or any contention by the SA PMs that the State's policy

of not collecting State cigarette excise tax on Tribal NPM Packs violates or breaches any requirement or standards under the MSA (except as provided in Section III.B.10 of the NY NPM Settlement). See APPENDIX D—"NY NPM SETTLEMENT".

The NY NPM Settlement also provides that if the State has (at any time) a law, regulation, systematic policy or agreement of not collecting State cigarette excise tax on any NPM cigarettes sold to State consumers other than Tribal NPM Packs, those NPM cigarettes will be included in the volume of cigarettes to which the Tribal NPM Pack credit applies, and the Investigator will determine the volume of such NPM cigarettes as part of its investigation under the process described above.

Non-Compliant SET-Paid NPM Sales Credit

The "**Non-Compliant SET-Paid NPM Sales Credit**" relates to sales of NPM cigarettes on which State cigarette tax was paid but there was not compliance with the escrow deposit requirement of the State's Qualifying Statute or the required escrow deposit was made but then released other than pursuant to the terms of the State's Qualifying Statute ("**Non-Compliant SET-Paid NPM Cigarettes**"). The amount of the Non-Compliant SET-Paid NPM Sales Credit for the OPMs for any sales year, beginning with 2015, is equal to number of Non-Compliant SET-Paid NPM Cigarettes on which the State collected its SET during the year multiplied by an amount, per cigarette, equal to three times the per cigarette escrow amount for the year under the State's Qualifying Statute. The per cigarette escrow amount for 2015 under the State's Qualifying Statute is the 2007 amount of $0.0188482 as adjusted for inflation consistent with the Inflation Adjustment under the MSA, or $0.0241270 per cigarette.

The Non-Compliant SET-Paid NPM Sales Credit, if any, shall be applied to the SA PMs' payments due on April 15 during the calendar year two years following the year for which the credit is calculated. For example, the credit for sales year 2015 will be applied to the April 15, 2017 payments under the MSA and be added to the applicable Tribal NPM Credits.

The NY NPM Settlement provides both (a) a safe harbor for the State to avoid in any year the Non-Compliant SET-Paid NPM Sales Credit and (b) an option for the SA PMs to elect to receive either the Non-Compliant SET-Paid NPM Sales Credit or to apply the NPM Adjustment under the MSA, with both the safe harbor and the SA PM election dependent on the level of sales of Non-Compliant SET-Paid NPM Cigarettes.

Under the safe harbor provisions, the State can totally avoid the Non-Compliant SET-Paid NPM Sales Credit by demonstrating that either (a) the total number of Non-Compliant SET-Paid NPM Cigarettes sold during the year did not exceed 4% of all NPM cigarettes on which SET was paid during the year or (b) the total number of Non-Compliant SET-Paid NPM Cigarettes sold during the year did not exceed two million cigarettes.

The SA PMs can elect to receive the Non-Compliant SET-Paid NPM Sales Credits for the year or to apply the NPM Adjustment under the MSA for the year if (A) the number of NPM cigarettes on which SET was paid during the year equals or exceeds 40 million, and (B) at least 20% of such SET-paid NPM cigarettes are Non-Compliant SET-Paid NPM Cigarettes. Receipt of Non-Compliant SET-Paid NPM Sales Credits will be deemed selected by the SA PMs unless SA PMs with at 87 percent of market share in the year in question chose to apply the NPM Adjustment in the MSA. In either event, the Tribal NPM Packs Credit would continue. See "STATE LAWS RELATED TO MSA—State Enforcement Agencies" for a discussion of the State's cigarette tax enforcement framework.

With respect to the 4% and 20% thresholds included in the two tests, the State Attorney General's office reported in its "NYS Settlement Agreement Supplemental Guidance" dated December 21, 2015 that since 2003 the total number of Non-Compliant SET-Paid NPM cigarettes sold in any year has not exceeded 1% of all NPM cigarettes on which State cigarette tax was paid.

Calculation of the Non-Compliant SET-Paid NPM Sales Credit will be based on information provided by the State by July 15 of the year following the year for which the credit is being calculated to establish (a) the amount of escrow deposited by or on behalf of each NPM for the year at issue on NPM cigarettes on which SET was paid (as well as releases or refunds of escrow), (b) the number of NPM cigarettes on which SET was paid in the year at

issue, and (c) the basis for any claimed exclusion of NPM cigarettes from being Non-Compliant SET-Paid NPM Cigarettes by virtue of (i) recovery at the escrow rate by the State on an escrow bond posted pursuant to State law (without release of any of the amount recovered other than pursuant to the State's Qualifying Statute), or (ii) an automatic stay in a federal bankruptcy proceeding or by other court order to the effect that enforcing escrow deposits is barred by federal or State constitutional law (other than State constitutional provisions added after December 14, 2012 or State constitutional law related to sovereign immunity or other Native American issues).

Other Provisions of the NY NPM Settlement

Arbitration of Disputes

Except as otherwise provided therein, disputes under the NY NPM Settlement shall be resolved through binding arbitration between the interested SA PMs (as a side) and the State (as a side).

RYO Cigarettes

For purposes of determining the amount of Non-Compliant SET-Paid NPM Cigarettes used in calculating the Non-Compliant SET-Paid NPM Sales Credit, references to a number of cigarettes include roll-your-own tobacco with 0.09 ounce of "roll-your-own" tobacco constituting one cigarette. For all other purposes of the NY NPM Settlement, references to a number of cigarettes include roll-your-own tobacco with 0.0325 ounce of roll-your-own tobacco constituting one cigarette.

CERTAIN FACTORS AFFECTING TRIBAL NPM PACKS SALES

General

The Tribal NPM Packs Credit for 2015 and later years is based on estimated sales to State non-tribal consumers on, from or through Native American reservations in the State of Tribal NPM Packs, including NPM cigarettes manufactured on the reservations, without payment of SET. At any time, the level of such sales may be affected by numerous factors, including the following:

- the amounts of the State cigarette excise tax and State and local sales tax avoided by consumers by purchasing Native American-made cigarettes from on-reservation tribal outlets;
- the retail price of NPM cigarettes manufactured on reservations by Native American manufacturers and the quality or perceived quality of those cigarettes relative to both the premium brands and the discount brands of the OPMs and SPMs;
- the location of the Native American reservations and other tribal lands within the State, the location of Native American retail outlets selling untaxed cigarettes on those reservations or lands, and the proximity of those retail outlets to major population centers and major highways, including interstate highways, within the State;
- the ability of the State under federal law (including treaties with State tribes) to compel reservation-based tribal retailers to collect the SET on cigarettes sold to non-Native American State consumers, including cigarettes manufactured on reservations by Native American manufacturers and purchased wholesale directly from those manufacturers;
- the ability of the State under federal law (including treaties with State tribes) to compel tribal cigarette manufacturers who sell cigarettes intended for resale to non-Native American State consumers, including resale by tribal retailers located on reservations, to sell only to State stamping agents in compliance with State law;
- with respect to Native American vendors of Tribal NPM Packs, the degree of compliance with, and enforcement of, State and federal laws prohibiting internet and mail order sales of cigarettes;
- assuming the State has a basis under federal law to proceed with respect to any particular enforcement action, the willingness of the State, as a matter of public policy, to undertake

enforcement actions against reservation manufacturers and/or retailers to compel collection of the SET on retail sales on reservations to non-Native American State consumers;

- the degree of compliance with, and enforcement of cigarettes on which the States cigarettes has not been paid, of, State and federal laws prohibiting the transportation of untaxed cigarettes into and within the State, including the smuggling of cigarettes from low-tax states, the production and distribution of counterfeit cigarettes purporting to be cigarettes of PMs, and shipments from Native American reservations located in other states and between Native American reservations within the State; and
- with respect to any particular Native American tribe or nation within the State, whether the State and such tribe or nation has entered into an agreement expressly relating to State taxation of cigarette sales on the tribe's or nations reservation (such as the Oneida Nation Agreement discussed below; see "—Oneida Nation Agreement").

State Cigarette Tax Statutes

Imposition of State Cigarette Tax; Cigarette Sales on Qualifying Reservations

Since 2010, the SET has been $4.35 per package of twenty cigarettes, which makes the SET the highest cigarette tax imposed by any state. New York City imposes a local excise tax at the rate of $1.50 per pack of twenty cigarettes, bringing the combined tax rate in New York City to $5.85, which is second only to Chicago's $6.16 per pack tax as the highest combined state and local cigarette tax rate in the United States.

Section 471 of State Tax Law imposes the SET on all cigarettes possessed in the State by any person for sale with limited exceptions, including circumstances under which the State "is without power to impose such tax, including sales to qualified Indians for their own use and consumption on their nations' or tribes' qualified reservations" in the State. Section 471 states that "[t]he tax imposed by this section is imposed on all cigarettes sold on an Indian reservation to non-members of the Indian nation or tribe and to non-Indians and evidence of such tax shall be by means of an affixed cigarette tax stamp." Section 471-e of the State Tax Law provides that "qualified Indians" may purchase cigarettes for their own use or consumption on their nation's or tribe's reservations or other lands exempt from SET. A "qualified Indian" is defined in Section 470 of State Tax Law as "[a] person duly enrolled on the tribal rolls of one of the Indian nations or tribes". The exemption under Section 471-e does not apply to purchases (a) by qualified Indians off their reservations, or on another nation's or tribe's reservation, or (b) by non-Native Americans making purchases of cigarettes on an Native American reservation. As described below, Section 471 as it relates both to sales to Native Americans for their own use on their reservations and to sales to non-Native Americans made on reservations is generally consistent with United States federal law as established by decisions of the United States Supreme Court. See "—Legal Considerations Relating to Collection of State Cigarette Tax on Tribal Sales." However, the State's Native American tribes and nations have generally maintained that, as sovereign peoples (and, in some cases, by virtue of historical treaties), they are not subject to the State's statutes with respect to sale of Native American-made cigarettes on reservations and other tribal lands, and the State has not been enforcing the State's cigarette tax with respect to cigarettes manufactured on reservations in the State and sold tax free from "smoke shops" and other outlets located on Native American reservations. As evidenced by the NY NPM Settlement provisions with respect to Tribal NPM Packs, reservation-based Native American wholesalers and retailers in the State historically have not complied with the State's SET stamping requirements and the State has not compelled compliance. (See "—History of State Taxation of Cigarettes Sold on Native American Reservations.")

Section 471-e of the State Tax Law also provides that if a Native American nation or tribe and the State enter into an agreement, approved by the State legislature, regarding the sale and distribution of cigarettes on the nation's or tribe's qualified reservation, the terms of such agreement shall take precedence over the provisions of Article 20 of State Tax Law (which includes Sections 471 and 471-e) and exempt such nation or tribe from such taxes to the extent that such taxes are specifically referred to in an agreement, and the sale or distribution, including transportation, of any cigarettes to the nation's or tribe's qualified reservation shall be in accordance with the provisions of such agreement. (See "—Oneida Nation Agreement" below.)

Oneida Nation Agreement

In May of 2013, the Oneida Nation of New York (the "**Oneida Nation**"), the State, and two counties in the State (Madison and Oneida) entered into a settlement agreement (the "**Oneida Nation Agreement**") to resolve long-standing disputes regarding casino gaming, property taxes and other taxes, as well as the status of Oneida Nation lands. The State Legislature approved the Oneida Nation Agreement in June 2013, and United States district court approval was obtained in March 2014.

Among the tax disputes addressed were disputes relating to taxes on cigarettes and tobacco products. The Oneida Nation Agreement provides that the Oneida Nation, pursuant to its governmental authority as an Native American nation to impose taxes upon sales occurring on Oneida Nation land, shall adopt and implement an ordinance to impose certain taxes and pricing standards, including those related to cigarettes and tobacco products as follows:

(i) To the extent the State imposes taxes on cigarettes and tobacco products possessed, transported, sold or conveyed throughout the State, the Oneida Nation shall impose its own tax on cigarettes and tobacco products possessed, transported, sold or conveyed by any seller on Oneida Nation land to non-Native American purchasers which shall be no less than the State taxes (with the Oneida Nation tax to rise with any increase in the State's cigarette and tobacco product taxes);

(ii) To the extent that the State or the local governments with jurisdiction over Oneida Nation lands impose sales tax, the Oneida Nation shall impose a corresponding sales tax on the same terms at a rate no less than the combined State and local governments rates (with such Oneida Nation rates to rise with any increase in the State and local government sales tax rates);

(iii) To the extent that the State mandates minimum prices on the sale of cigarettes, the Oneida Nation shall impose minimum prices on the sale of the same cigarettes, with the Oneida Nation minimum prices to be calculated in the same manner as the corresponding State minimums;

(iv) The Oneida Nation may receive unstamped cigarettes directly from federally licensed manufacturers without going through a State licensed cigarette stamping agent. The Oneida Nation shall affix its cigarette stamp on all such cigarettes, including cigarettes that the Oneida Nation may exclude from Oneida Nation taxes on the basis that the sale constitutes a retail sale on Oneida Nation lands by the Oneida Nation to a Native American or the immediate family of a Native American member living in the same household;

(v) Any sale of cigarettes bearing the Oneida Nation tax stamp that occurs off Oneida Nation lands shall be subject to State cigarette taxes unless there is proof that the Oneida Nation cigarette tax has been paid;

(vi) The collection by the Oneida Nation of its taxes on cigarettes and tobacco products as described above shall be in full satisfaction of State cigarette and tobacco products taxes on Oneida Nation land, and compliance with the Oneida Nation Agreement shall be deemed compliance with State law relative to the payment and collection of taxes; and

(vii) The Oneida Nation shall report to the State its purchases of cigarettes from manufacturers for the express and limited purpose of ensuring appropriate third-party compliance with the requirements of the MSA.

Although the Oneida Nation Agreement requires the payment of tax to the Oneida Nation comparable to the SET, any NPM cigarettes sold at Oneida Nation outlets with Oneida Nation tax paid nonetheless constitute "Tribal NPM Packs" for purposes of the Tribal NPM Packs Credit, which relates to all NPM cigarettes sold from Native American reservations in the State to State consumers (other than to Native American residents of the reservation for personal consumption) without payment to the State of the State cigarette tax.

The Oneida Nation has reported purchases of the following quantities of cigarettes for consumption or resale in the Oneida Nation, on which Oneida Nation tribal cigarette stamps were affixed, for the following periods:

Period	PM Packs to Tribal and Non-Tribal Consumers	NPM Packs to Tribal and Non-Tribal Consumers	Total
Sept.-Nov. 2014	144,443	496,880	641,323
Dec. 2014-Feb. 2015	143,706	453,580	597,286
Mar.-May 2015	207,170	517,200	724,370
June-Aug. 2015	189,581	497,400	686,981
Sept.-Nov. 2015	203,745	493,500	697,245
Dec. 2015-Feb. 2016	161,075	283,200	444,275
Mar.-May 2016	209,139	325,200	534,339
Total: Sept. 2014-May 2016	**1,258,859**	**3,066,960**	**4,325,819**

The Oneida Nation Agreement states that the Oneida Nation shall use revenues from cigarette and sales taxes (as well as other taxes described in the Oneida Nation Agreement) exclusively for the provision of the same types of governmental programs and services, and to the discharge by the Oneida Nation of the same type of governmental obligations, for which the State and local governments use their tax collections.

The Oneida Nation Agreement requires the Oneida Nation to contract for an independent third party acceptable to the State to assess and report to the State annually regarding the Oneida Nation's compliance with the tax provisions of the Oneida Nation Agreement. If any such report indicates that the Oneida Nation has failed to comply with the provisions of the Oneida Nation Agreement relating to imposition and collection of the Oneida Nation cigarette tax, then such provisions shall be void and State tax law (Articles 20 and 20-A) shall apply.

The Oneida Nation Agreement also provides that if the State enters into an agreement with any other Native American nation or tribe containing any provision relating to, among other things, the importation, possession, transportation, purchase, sale or conveyance of cigarettes or tobacco products among or between any other Native American nation(s), the State shall, pursuant to the Oneida Nation Agreement, provide a copy of such other agreement to the Oneida Nation, which shall have the option, upon notice to the State, of adopting such other provision which, if so adopted, shall amend or replace any existing provision of the Oneida Nation Agreement relating to any importation, possession, transportation, purchase, sale or conveyance of cigarettes or tobacco products among or between any other Native American nation(s).

History of State Taxation of Cigarette Sales on Native American Reservations

The State in 1939 enacted a cigarette excise tax statute and adopted a policy of forbearance with respect to the collection of the tax on sales of all cigarettes sold on or through Native American reservations. Despite efforts to change the policy, the policy of forbearance continued with few interruptions until 2010 when the State legislature enacted a statute directing the State Department of Taxation and Finance (the "**State Tax Dept.**") to adopt regulations to fully implement State Tax Law Section 471 subd. 5 and Section 471-e (which establish that cigarettes sold on reservations to non-Native Americans are subject to SET). Lawsuits challenging this legislation delayed implementation until mid-2011. Since then, the State's formerly official policy of forbearing on collection of SET on all cigarettes sold to Native American tribes and nations, including cigarettes sold for resale to non-Native Americans, has been changed to an official policy of exemption from SET of only cigarettes sold to the State's Native Americans for the own consumption based on "probable demand" and an unofficial policy of not enforcing collection of SET on retail sales of Native American-made cigarettes from reservation outlets. The change of policy in 2010-11 followed earlier aborted attempts to limit untaxed sales by the State's tribes.

As discussed further in the IHS Global Tribal Sales Report, the reported cigarette sales from off-reservation manufacturers to Indian nations in the State, expressed as a percentage of the total reported State tax stamp sales, has fluctuated from the 1980s to 2011, due to differing laws and enforcement policies, from approximately 0.5% at the outset of reporting in 1984, to a high of approximately 43.2% in 2005, to 21.1% in 2011 (the last year in which such sales to Indian nations in the State were greater than zero). See APPENDIX A-2—"IHS GLOBAL TRIBAL

SALES REPORT." The IHS Global Tribal Sales Report also discusses the historical geographic concentration of such sales to Indian nations in the State during certain years.

Since June 30, 2011, licensed Stamping Agents have reported no sales of unstamped cigarettes to reservation outlets, including no sales within the probable demand allowances. State tribal nations have reportedly stopped selling cigarettes, including major brand cigarettes, purchased through State stamping agents, turning instead to cigarettes made by Native American-owned manufacturers that are purchased directly from the manufacturers or through Native American-owned distributors. To date the State has not moved to enforce its cigarette tax statutes by taking direct action against either (i) Native American cigarette manufacturers located on reservations in the State or (ii) Native American retail outlets marketing Native American made cigarettes. Tribal manufacturers do not disclose to the State their production or sales figures and the State to date has not conducted on-reservation audits or record inspections in light of tribal sovereignty and federal law constraints. Although Native American-owned cigarette manufacturers are required to pay federal taxes on each pack sold, the U.S. Treasury has reportedly declined to release that taxpayer information to the State.

Neither the State Attorney General's office nor the State Tax Dept. have announced plans to curtail the retail sale of untaxed Native American-manufactured cigarettes at reservations outlets in the State. However, the State has undertaken off-reservation efforts to impede the intra- and interstate distribution of untaxed cigarettes.

Legal Considerations Relating to Collection of State Cigarette Tax on Tribal Sales

The ability of states, including the State, to impose their laws and regulations, including tax laws and regulations, on Native American reservations and lands is constrained by the federal law of the United States, including the United States constitution and the doctrine of tribal sovereignty, and, in the case of certain tribes, by treaties made between the tribes and the federal government. The concept of tribal sovereignty arose historically from the fact that the Native American tribes or nations were sovereign peoples when the colonists arrived, and, as two sovereign peoples, the tribes and the colonists negotiated treaties. Later, the United States Constitution gave Congress, and not the states, power "to regulate commerce with foreign nations . . . and with the Indian tribes."

Since the early part of the nineteenth century, various courts, including the U.S. Supreme Court, have issued decisions establishing a special status for Native American sovereignty. In rendering their decisions on the particular statutes and facts in each case, the courts balanced the competing interests of the states (collecting taxes from non-Native Americans), the federal government (promoting tribal self-determination and constraining states from interfering with the federal government's preemptive powers to regulate Native American affairs) and the Native American tribes (promoting economic activity and retaining tribal sovereignty).

The U.S. Supreme Court dealt with a New York State cigarette tax case, *Department of Taxation and Finance of N.Y. v. Milhelm Attea & Bros*. In 1988, the State Tax Dept. had determined that a large volume of untaxed cigarettes were being purchased by non-Native Americans from reservation retailers causing losses to the State, and, as a consequence, issued regulations to limit the quantity of untaxed cigarettes that the State's cigarette stamping agents could deliver to reservation sellers. The amount of the untaxed cigarettes could be determined by agreement between a tribe and the State Tax Dept. or that Department could make a determination of the "probable demand" on the reservation, based on the reservation's population and the State average per capita cigarette consumption. The regulations required that the wholesalers and Native American retailers maintain records and follow procedures designed to limit the sale of untaxed cigarettes to non-Native Americans. The suit was brought in State court by State-licensed cigarette wholesalers, who were also federally-licensed Indian traders. The wholesalers sought an injunction against implementation of the regulations on the theory the regulations were pre-empted by the federal Indian Trader Statutes. The State trial court and State intermediate appellate court agreed to issue the injunction, and the State Court of Appeals denied review. The U.S. Supreme Court granted certiorari and remanded the case for further consideration in light of its decision in *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe of Oklahoma*, in which the Court rejected Oklahoma's argument that tribal sovereign immunity impermissibly burdens the administration of state tax laws and should be restricted to the internal affairs of the tribe. The Court in *Oklahoma Tax Commission* held that the doctrine of sovereign immunity "does not excuse a tribe from all obligations to assist in the collection of validly imposed state sales taxes" and held that Oklahoma could tax on-reservation cigarette sales to non-Native Americans, but found that tribal sovereign immunity still barred Oklahoma from suing the tribe to enforce its taxes. On remand in *Department of Taxation and Finance of*

N.Y. v. Milhelm, the New York intermediate appellate court upheld the State regulations, but the State Court of Appeals reversed, finding that the regulations were invalid because they imposed significant burdens on the wholesaler. Subsequently, the U.S. Supreme Court rejected the claim that the Indian Trader Statutes bar any and all burdens on Indian traders, and concluded that the regulations were not unduly burdensome. New York State's cigarette tax law as it relates both to sales to Native Americans for their own use on their reservations and to sales to non-Native Americans made on reservations is generally consistent with United States federal law as established by other decisions of the United States Supreme Court. See "—History of State Taxation of Cigarette Sales on Native American Reservations" above.

NEW YORK CONSENT DECREE

There follows a brief description of the Decree. This description is not complete and is subject to, and qualified in its entirety by reference to, the Decree, a copy of which is attached hereto as APPENDIX C.

Introduction and Overview

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

Calculating TSASC's Share of the Accounts and Flow of Funds

According to the formula set forth in the MSA, the State is entitled to 12.7620310% of the total amount deposited in the national escrow account. The allocation of the State's share of the Annual Payments to be made pursuant to the MSA to the State, the City and the other counties is set forth in the Decree, which provides that the State is to receive 51.176%, the City is to receive 26.670% and the other counties within the State are collectively to receive 22.154% of the Annual Payments. The Decree provides for <u>no</u> allocation of Strategic Contribution Payments to the City or any of the other counties.

TSASC has purchased the Tobacco Assets, which are all of the City's right, title and interest in and to such payments, pursuant to the TSR Purchase Agreement. Under the Indenture, however, TSASC has assigned and pledged only 37.40% of the Tobacco Assets, constituting the Pledged TSRs, to the Indenture Trustee as security for the Bonds. The State and the City have issued irrevocable instructions informing the MSA Escrow Agent that the Pledged TSRs payable to the City under the Decree have been sold to TSASC pursuant to the TSR Purchase Agreement, and directing the MSA Escrow Agent to disburse such TSRs directly to the Indenture Trustee. Accordingly, the Pledged TSRs to which TSASC is entitled are paid directly to the Indenture Trustee by the MSA Escrow Agent, are not to pass through either the State or the City, and are not to be subject to State or City appropriation.

Rights to Enforce Provisions of the Decree

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

Release and Dismissal of Claims

The Decree further provides that the City and the counties unconditionally will release and discharge all released claims against all Released Parties to the same extent that the State released its claims pursuant to the MSA. The City and the counties have agreed that they will not seek to establish civil liability against any Released Party upon any released claim and that such agreement will be a complete defense to any such civil action or proceeding.

CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY

The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry, and other public sources. Certain of those companies, including Altria Group, Inc., Reynolds American, Inc. and Vector Group Ltd., currently file annual, quarterly and certain other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-8090; e-mail: publicinfo@sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although TSASC has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, TSASC 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 New York Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2017 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2017 Bonds is consistent with their investment objectives.

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

Retail market share information, based upon shipments or sales as reported by the OPMs for purposes of their filings with the SEC, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the PMs to contribute to Annual Payments. The Relative Market Share information reported is confidential under the MSA, except to the extent reported by NAAG. See "SUMMARY OF THE MSA—Overview of Payments by the Participating Manufacturers; MSA Escrow Agent" and "—Annual Payments". Additionally, aggregate market share information, based upon shipments as reported by Reynolds American Inc. (the parent company of Reynolds Tobacco) and Altria Group, Inc. (the parent company of Philip Morris) and reflected in the chart below entitled "Manufacturers' Domestic Market Share of Cigarettes" is different from that utilized in the bond structuring assumptions. See "PLEDGED TSRs PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

Industry Overview

According to publicly available documents of the OPMs, at year-end 2015 the OPMs collectively accounted for approximately 83.3% of the domestic cigarette retail industry, as discussed in "Industry Market Share" below. As reported by NAAG, based upon OPM shipments reported to MSAI, the OPMs accounted for approximately 84.54% of the domestic cigarette market in sales year 2015 measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate. The market for cigarettes in the U.S. divides generally into premium and discount sales. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, premium cigarettes represented approximately 72.8% of total U.S. industry shipments.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, Altria was named Philip

Morris Companies Inc. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Altria reported that Philip Morris's domestic cigarette market share for such period was 51.4% (based on retail sales data from IRI/MSAI, a tracking service that uses a sample of stores and certain wholesale shipments to project market share and depict share trends). In its Form 10-K filed with the SEC for calendar year 2015, Altria reported that Philip Morris's domestic cigarette market share for calendar year 2015 was 51.3% , which represents an increase from its reported domestic market share of 50.9% for calendar year 2014. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament (with Marlboro representing approximately 85.7% of Philip Morris's domestic cigarette shipment volume during the nine-months ended September 30, 2016, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016). Marlboro is also the largest selling cigarette brand in the U.S., with approximately 44.0% of the U.S. domestic retail share at September 30, 2016 and September 30, 2015, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, and has been the world's largest-selling cigarette brand since 1972. Philip Morris's principal discount brands are Basic and L&M. In 2009, Altria acquired UST LLC, whose subsidiary, U.S. Smokeless Tobacco Company LLC ("**UST**"), is the leading producer of smokeless tobacco in the U.S.

R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), a wholly-owned subsidiary of Reynolds American Inc. ("**Reynolds American**"), is the second largest tobacco company in the U.S. On June 12, 2015, Reynolds American acquired Lorillard, Inc., the parent company of Lorillard Tobacco Company ("**Lorillard**"). In connection with the merger, Lorillard (the then third-largest tobacco company in the U.S.) merged with and into Reynolds Tobacco (the then second-largest tobacco company in the U.S.), with Reynolds Tobacco continuing as the surviving entity. In an earlier merger, on July 30, 2004, the U.S. operations of Brown & Williamson Tobacco Corporation ("**B&W**") (the then third-largest tobacco company in the U.S.) were combined with Reynolds Tobacco. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at September 30, 2016 was 32.3% (based on shipments to retail outlets and information submitted by wholesale locations and processed and managed by MSAI). In its Form 10-K filed with the SEC for the calendar year 2015, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at December 31, 2015 was 32.0%. Reynolds Tobacco's major premium brands are Newport (which it acquired in the merger with Lorillard) and Camel, and its discount brands include Pall Mall and Doral. Reynolds American is also the parent company of American Snuff Company, LLC, the second-largest smokeless tobacco products manufacturer in the U.S., and Santa Fe Natural Tobacco Company, Inc., an SPM that manufactures a super-premium cigarette brand.

Contemporaneous with the merger of Lorillard, Inc. into Reynolds American, Imperial Tobacco Group PLC ("**Imperial Tobacco**") (through its subsidiary ITG Brands, LLC, an SPM under the MSA) purchased Reynolds Tobacco's Kool, Salem and Winston cigarette brands, Lorillard, Inc.'s Maverick cigarette brand and blu eCig electronic cigarette brand, and other assets. Imperial Tobacco is listed on the London Stock Exchange and does not file quarterly or annual reports with the SEC. According to Imperial Tobacco's annual report for the fiscal year ended September 30, 2015, Imperial Tobacco's market share in the U.S. tobacco market at fiscal year-end 2015 was 9.5%, making it the third-largest tobacco company in the U.S. market. In accordance with Section XVIII(c) of the MSA, which states that "[n]o Original Participating Manufacturer may sell or otherwise transfer or permit the sale or transfer of any of its Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses … to any person or entity unless such person or entity is an Original Participating Manufacturer or prior to the sale or acquisition agrees to assume the obligations of an Original Participating Manufacturer with respect to such Cigarette brands, Brand Names, Cigarette product formulas or businesses," the OPM payment obligations under the MSA with respect to the cigarette brands, brand names, cigarette product formulas and businesses acquired by Imperial Tobacco from Reynolds Tobacco and Lorillard have been assumed and continued by Imperial Tobacco. Imperial Tobacco also is the parent company of Commonwealth Brands, Inc. ("**CBI**"), an SPM under the MSA, which markets deep discount brands in the U.S., including USA Gold, Sonoma and Fortuna.

On October 21, 2016, British American Tobacco p.l.c. ("**BAT**") announced its offer to acquire all Reynolds American stock not currently owned by BAT. BAT currently owns approximately 42% of Reynolds American shares, and its acquisition proposal entails the purchase of all other Reynolds American shares for approximately $47 billion in a combined cash and stock transaction. As noted above, the payment obligations under the MSA follow tobacco product brands if they are transferred; thus, if the acquisition is approved and consummated and if BAT is the surviving entity, BAT will be required to make payments under the MSA attributable to the acquired

Reynolds American cigarette brands. Following the announcement of BAT's acquisition offer, S&P placed BAT's long-term corporate debt on "CreditWatch Negative".

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for calendar year 2015 was held by a number of other cigarette manufacturers, including Liggett Group, LLC ("**Liggett**") (the operating successor to the Liggett & Myers Tobacco Company) and Vector Tobacco Inc. ("**Vector Tobacco**"), each SPMs under the MSA and each wholly-owned subsidiaries of Vector Group Ltd. ("**Vector Group Ltd.**"). In its Form 10-K filed with the SEC for the calendar year 2015, Vector Group Ltd. reported that its subsidiary Liggett's domestic market share in the calendar year 2015 was 3.3%, measured by MSAI shipment volume data (compared to 3.4% during 2014), and that all of Liggett's unit sales volume in 2015 (and all years since 2004) was in the discount segment. The domestic market share of Vector Group Ltd.'s subsidiary Vector Tobacco is negligible. Vector Group Ltd. reported in its Form 10-K filed with the SEC for the calendar year 2015 that Liggett and Vector Tobacco are required to make payments under the MSA to the extent such companies' market share exceeds approximately 1.65% and approximately 0.28%, respectively, of the U.S. cigarette market (with the MSA payment obligations based on each respective company's incremental market share above the aforementioned minimum thresholds). Vector Group Ltd.'s brands include Pyramid, Eagle 20's, Grand Prix and Liggett Select.

Industry Market Share

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

Manufacturers' Domestic Market Share of Cigarettes[1]

	Calendar Year					
Manufacturer	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Philip Morris	49.8%	49.0%	49.8%	50.7%	50.9%	51.3%
Reynolds Tobacco[2]	28.1	27.4	26.5	26.0	26.5	32.0
Imperial Tobacco[3]	----	----	----	----	----	9.5
Lorillard[4]	12.3	14.1	14.4	14.9	15.1	----
Other[5]	9.8	9.5	9.3	8.4	7.5	7.2

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

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

3 According to Imperial Tobacco's annual report for its fiscal year ended September 30, 2015, the 2015 amount shown reflects the combined performance of U.S. operations before and after the acquisition of the above-described assets of Reynolds Tobacco and Lorillard.

4 Lorillard utilized MSAI market share data in its SEC reports. MSAI divides the cigarette market into two price segments, the premium price segment and the discount or reduced price segment. MSAI's information relating to unit sales volume and market share of certain of the smaller, primarily deep discount, cigarette manufacturers is based on estimates derived by MSAI.

5 The market share specified in "Other" has been determined by subtracting the total market share percentages of Philip Morris, Reynolds Tobacco, Imperial Tobacco and Lorillard as reported in their publicly available documents from 100%. Results may not be accurate and may not total 100% due to rounding and the differing sources and methodologies utilized to calculate market share.

Cigarette Shipment Trends

The following table sets forth the industry's approximate cigarette shipments in the U.S. for the eight years ended December 31, 2015.

Years Ended December 31	Shipments (Billions of Cigarettes)[1]	Percent Change From Prior Year
2015	264.3	(0.1)%
2014	264.6	(3.2)
2013	273.3	(4.6)
2012	286.5	(2.3)
2011	293.1	(3.5)
2010	303.7	(3.8)
2009	315.7	(8.6)
2008	345.3	(3.3)

[1] As reported in SEC filings of the parent company of Reynolds Tobacco, based on MSAI data.

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

According to data from NAAG, overall shipments increased approximately 1.94% to 270.830 billion cigarettes in sales year 2015 from 265.688 billion cigarettes in sales year 2014 measuring roll-your-own tobacco sales at a 0.0325 ounce per cigarette conversion rate. According to data from NAAG, OPM shipments decreased approximately 0.15% to 226.214 billion cigarettes in sales year 2015 from 226.553 billion cigarettes in sales year 2014 measuring roll-your-own tobacco sales at a 0.0325 ounce per cigarette conversion rate. Overall shipments in sales year 2014, according to data from NAAG, decreased approximately 3.84% measuring roll-your-own tobacco sales at a 0.0325 ounce per cigarette conversion rate from sales year 2013. OPM shipments in sales year 2014, according to data from NAAG, decreased approximately 3.53% measuring roll-your-own tobacco sales at a 0.0325 ounce per cigarette conversion rate from sales year 2013. According to NAAG data, domestic U.S. cigarette shipments over the past 10 available reported sales years was approximately as set forth in the table below.

Sales Year	Overall No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)	% Change From Prior Year (with 0.0325 oz. RYO conversion)[1]	OPM No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)	% Change From Prior Year (with 0.0325 oz. RYO conversion)[1]
2015	270.830	1.94 %	226.214	(0.15) %
2014	265.688	(3.84)	226.553	(3.53)
2013	276.287	(4.86)	234.841	(4.34)
2012	290.404	(1.94)	245.486	(1.99)
2011	296.159	(2.75)	250.461	(3.09)
2010	304.547	(6.36)	258.440	(3.96)
2009	325.226	(9.09)	269.095	(10.35)
2008	357.738	(3.79)	300.161	(3.92)
2007	371.833	(4.96)	312.411	(4.50)
2006	391.256	0.26	327.123	(1.49)

[1] Percentage change calculated after rounding of shipment volume.

According to data from the U.S. Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau (the "**TTB**"), the overall quantity of cigarettes shipped domestically (not including a conversion for roll-your-own tobacco) increased approximately 1.95% to approximately 267.835 billion cigarettes in 2015 from approximately

262.704 billion cigarettes in 2014. Such shipments in 2014 represented an approximately 4.05% decrease from cigarette shipments in 2013. According to the TTB, the quantity of cigarettes shipped domestically for the past 10 calendar years was approximately as set forth in the table below.

Calendar Year	No. of Cigarettes (in billions)	Percent Change From Prior Year[1]
2015	267.835	1.95 %
2014	262.704	(4.05)
2013	273.787	(4.77)
2012	287.487	(1.80)
2011	292.769	(2.57)
2010	300.489	(5.52)
2009	318.029	(8.20)
2008	346.419	(4.22)
2007	361.665	(5.01)
2006	380.726	(0.10)
2005	381.107	(4.31)

[1] Percentage change calculated after rounding of shipment volume.

The MSA payments are calculated in part on shipments by the OPMs in or to the U.S., rather than total industry shipments (as shown in the tables above), and rather than consumption.

Physical Plant, Distribution, Competition and Raw Materials

The production facilities of the OPMs tend to be highly concentrated. Material damage to these facilities could materially impact overall cigarette production. A prolonged interruption in the manufacturing operations of the cigarette manufacturers could have a material adverse effect on the ability of the cigarette manufacturers to effectively operate their respective businesses.

Cigarette manufacturers sell tobacco products to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. However, certain stores have ceased the sale of tobacco products. The retail chain store Target stopped selling tobacco products in 1996. In September 2014, the national pharmacy chain CVS reportedly stopped selling all cigarettes and other tobacco products in all its stores (following a February 2014 announcement), citing that such sales were inconsistent with its mission. CVS recently reported that a year after it stopped selling cigarettes, cigarette sales across all retailers have dropped in 13 states where it has sizable market share. A group of U.S. Attorneys General have pressured large retail stores with pharmacies to take similar action, and in April 2014 several members of Congress called on these retailers to stop selling cigarettes and other items containing tobacco. Costco also reportedly has gradually removed tobacco products from approximately half of its U.S. locations, according to news reports in May 2014. Cigarette manufacturers and their affiliates and licensees also market cigarettes and other tobacco products worldwide, directly or through export sales organizations and other entities with which they have contractual arrangements.

The domestic market for cigarettes is highly competitive. Competition is primarily based on a brand's price, including the level of discounting and other promotional activities, positioning, product attributes and packaging, consumer loyalty, advertising, retail display, quality and taste. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. 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.

E-Cigarettes and Vapor Products

Numerous manufacturers have recently developed (or acquired) and are marketing "electronic cigarettes" (or "e-cigarettes"), which, while not tobacco products, are battery powered devices in the shape of a cigarette that vaporize liquid nicotine, which is then inhaled by the consumer. Because they do not contain, burn or heat tobacco, the manufacturers (and certain states) do not deem e-cigarettes to constitute "cigarettes" within the meaning of the MSA. Electronic nicotine products also include devices called "vaporizers", which are larger, customizable devices. They have larger batteries and cartridges, hold more liquid, produce larger vapor clouds and last longer. They allow users to mix and match hardware and refill cartridges with liquid bought in bulk, so that they generally are cheaper than e-cigarettes. As discussed below, in May 2016, the U.S. Food and Drug Administration ("**FDA**") released its final rule which subjects manufactures, importers and/or retailers of e-cigarettes, other vapor products and certain other tobacco related products to the same and additional regulations applicable to cigarettes, cigarette tobacco, roll-your-own tobacco and smokeless tobacco. However, e-cigarettes and vapor products are currently not subject to the advertising restrictions to which tobacco products are subject. According to the American Lung Association, there are nearly 500 brands and 7,700 flavors of e-cigarettes on the market.

The parent companies of each of the OPMs have launched e-cigarette brands. Reynolds American markets the e-cigarette product VUSE. Reynolds American reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that the national expansion of VUSE was completed in early 2015, and in March 2016, it introduced its VUSE FOB power unit, which offers an on-device display with information about battery and cartridge levels. Altria's subsidiary Nu Mark LLC introduced e-vapor products under the "MarkTen" brand in 2013 and expanded MarkTen nationally during 2014. MarkTen is an e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. In April 2014, Altria, through its Nu Mark subsidiary, acquired the e-vapor business of Green Smoke, Inc., an e-cigarette maker that sells both disposable and reusable products. In July 2015 Altria announced the expansion of its strategic framework with Philip Morris International Inc. to include a joint research, development and technology-sharing agreement pursuant to which they will collaborate to develop e-vapor products for commercialization in the U.S., according to Altria in its Form 10-K filed with the SEC for the calendar year 2015. In April 2012 Lorillard, Inc. acquired the blu eCigs brand, which it sold to Imperial Tobacco contemporaneously with the Lorillard, Inc. merger into Reynolds American in 2015. In addition, Vector Group Ltd.'s subsidiary Zoom E-Cigs LLC rolled out its Zoom e-cigarette brand nationally 2014.

E-cigarette and vapor product sales were an estimated $3.5 billion in 2015 and are projected to reach $4.1 billion in 2016, according to news reports. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that its subsidiaries believe that a significant number of adult tobacco consumers switch between tobacco categories, use multiple forms of tobacco products and try innovative tobacco products, such as e-vapor products and that, although the e-vapor category grew rapidly from 2012 through 2015, the category has slowed since that time.

The CDC in September 2014 reported results of a survey that indicated that in 2013 approximately 8.5% of the adult population (representing approximately two-and-a-half times the 2010 estimates), and 36.5% of smokers (representing approximately four times the 2010 estimates), had tried e-cigarettes at some time. In January 2016 the CDC reported that in 2014 approximately 2.4 million middle and high school students were users of electronic cigarettes in the preceding 30 days. The CDC also reported that 16% of high school students used e-cigarettes in 2015 (compared to 1.5% in 2011). In December 2014 the University of Michigan's Survey for Research Center ("**UMSRC**") reported its findings that e-cigarette use exceeded traditional cigarette smoking among teens in 2014. In December 2015, the UMSRC reported its findings that in 2015, a substantially higher percentage of adolescents used e-cigarette's in the last 30 days than had smoked regular cigarettes and that cigarette smoking among teens continued a decades-long decline in 2015 and reached the lowest levels recorded since annual tracking began 41 year ago. In addition, it has been reported that increases in taxes on traditional cigarettes have caused an increase in the sale of e-cigarettes.

On May 5, 2016, the FDA released final rules that extend its regulatory authority to electronic cigarettes and certain other tobacco products under the FSPTCA (following an April 25, 2014 release of proposed rules). The

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

Electronic cigarettes are currently not subject to federal excise taxes. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016, five states and the District of Columbia imposed a tax on vapor products such as e-cigarettes. In addition, according to Reynolds American, during the first nine months of 2016, 19 states proposed taxes on vapor products, including, in some cases, implementing a tax on a per fluid milliliter basis, taxing vapor products on the same basis as "other tobacco products" and, in other cases, taxing vapor products at a rate equivalent to cigarette excise taxes. Such legislation was adopted in two states (Pennsylvania, effective October 1, 2016, and West Virginia), failed in 15 states, and, as of September 30, 2016, remained pending in two states, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Certain legislation has been passed by states and localities restricting the use and sale of electronic cigarettes and other vapor products. Ten U.S. states and two territories (California, Connecticut, Delaware, Hawaii, Maine North Dakota, New Jersey, Oregon, Utah, Vermont, Puerto Rico and the Northern Mariana Islands) and 566 municipalities have banned the use of e-cigarettes in smoke-free venues, and 15 states have restricted e-cigarette use in other venues, according to the American Nonsmokers' Rights Foundation ("**ANRF**") as of October 1, 2016. On December 19, 2013, the New York City Council approved legislation that prohibits the use of e-cigarettes in indoor public places and in places of employment (where smoking of traditional cigarettes is already prohibited). Chicago, Los Angeles, San Francisco and Philadelphia passed similar legislation in 2014. On March 2, 2016, the U.S. Department of Transportation announced a final rule that explicitly bans the use of e-cigarettes on commercial flights and applies to all scheduled flights of U.S. and foreign carriers involving transportation in, to, and from the U.S.

On January 28, 2016, President Obama signed the Child Nicotine Poisoning Prevention Act into law which requires containers for liquid nicotine used in e-cigarettes to have child-proof packaging.

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

Smokeless Tobacco Products

Smokeless tobacco products, which are not "cigarettes" within the meaning of the MSA, have been available for centuries. Chewing tobacco and snuff are the most significant components of this market segment. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff, including "snus" (originated in Sweden), is both smoke-free and potentially spit-free. As cigarette consumption expanded in the last century, the use of smokeless products declined. Recently, however, the industry has expanded its smokeless tobacco products in response to the general decline in cigarette consumption, the proliferation of smoking bans and the perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Snuff, for example, is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco (and a subsidiary of Altria, Philip Morris's parent company), which manufactures Copenhagen and Skoal smokeless products, among others, is explicitly targeting adult smoker conversion in its growth strategy. In 2006, the OPMs entered the market of smokeless tobacco products, including Philip Morris's introduction of Taboka, a snuff product, and Reynolds American's introduction of Camel snus. Philip Morris also markets Marlboro snus and Marlboro Smokeless

Tobacco Stick. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In 2009 Reynolds American began testing dissolvable tobacco products Camel Sticks (a twisted, dissolvable stick made of tobacco), Camel Orbs (dissolvable tobacco tablets) and Camel Strips (dissolvable tobacco strips), but in recent years has scaled back marketing of these products. In January 2012 Altria announced that it entered into an agreement with Okono, an affiliate of Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible tobacco products. In May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve nicotine discs, a mint-flavored, chewable, disposable tobacco product that contains tobacco-derived nicotine. Philip Morris has also developed an alternative cigarette, called Accord, in which the tobacco is electronically heated rather than burned. Furthermore, Altria reported in its Form 10-K filed with the SEC for the calendar year 2015 that in December 2013 its subsidiaries entered into an agreement with Philip Morris International Inc. providing for an exclusive license to Altria subsidiaries to sell two of Philip Morris International Inc.'s heated tobacco product technologies in the United States.

As a result of these efforts, smokeless tobacco products have been increasing market share of tobacco products overall at the expense of the market share captured by cigarettes. According to Reynolds American, as reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, U.S. moist snuff shipments to retail grew approximately 3.9% in the first nine months of 2016, with moist snuff's growth partially attributable to cigarette smokers switching from cigarettes to smokeless tobacco products or using both. Sales of moist snuff products have increased by 65.6% between 2005 and 2011, according to an October 2012 report by the National Center for Biotechnology Information. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, smokeless tobacco products accounted for approximately 8.1% of Altria's tobacco product net revenues for the nine-month period ended September 30, 2016, compared with approximately 7.5% for the nine-month period ended September 30, 2015, and it estimates that its domestic smokeless products shipment volume grew approximately 5.5% and 6% for the nine and three months ended September 30, 2016, respectively. A June 2014 report by the CDC found that smokeless tobacco use among U.S. workers has remained relatively steady since 2005, with 2.7% of U.S. workers using smokeless tobacco products in 2005 and 3.0% of U.S. workers using smokeless tobacco products in 2010, while cigarette use has declined since 2005. The U.S. Department of Health and Human Services reports that 3.5% of all adults use smokeless tobacco.

On June 10, 2014, Swedish Match submitted an application to the FDA to (i) authorize under the FDA's premarket tobacco application ("**PMTA**") pathway the marketing and sale of updated versions of eight of its snus products under the "General" brand name and (ii) approve the snus products as a "modified risk tobacco product" ("**MRTP**") allowing the manufacturer to alter or remove certain warning labels from its packages and to make claims that its products present a lower risk than cigarettes. The FDA announced in November 2015 that it had for the first time authorized the marketing of a new tobacco product through the PMTA process by granting Swedish Match's application with respect to the marketing and sale of its snus products. Swedish Match's application for approval of the snus products as a MRTP are still under FDA review.

Smoking Cessation Products

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

Private health insurance carriers are increasing premiums on smokers, which often are passed on by the employer to the smoker-employee. Certain of these and other health insurance policies, including Medicaid and Medicare, cover various forms of smoking cessation treatments, making smoking cessation treatments more affordable for covered smokers.

Results of a study by the CDC released in October 2015 found that in 2013, approximately two-thirds of smokers had made a quit attempt in the past year (although state proportions ranged from 56.2% to 76.4%). According to a report issued by the CDC in November 2015, the smoking rate for adults in the United States fell to 16.8% in 2014. It is possible that many former smokers were aided by smoking cessation products.

Gray Market

A price differential (principally resulting from differing tax rates) exists between cigarettes manufactured for sale abroad and cigarettes manufactured for U.S. sale. Such differential increases as excise taxes in the U.S. are increased. Consequently, a domestic gray market has developed for cigarettes that are manufactured for sale abroad, but instead are diverted for domestic sales at substantially lower prices that compete with cigarettes manufactured for domestic sale. The U.S. federal government and all states, except Massachusetts, have enacted legislation prohibiting the sale and distribution of gray market cigarettes. In addition, Reynolds American has reported that it has taken legal action against certain distributors and retailers who engage in such practices, and that smuggling activities adversely impact the sale of tobacco products by PMs.

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives

The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. Several states charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. The Affordable Care Act allows insurance companies to charge smokers up to 50% higher premiums than non-smokers, and several large corporations are now charging smokers higher premiums.

Federal Regulation

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

In 1992, the federal Alcohol, Drug Abuse, and Mental Health Administration Reorganization Act was signed into law. This act required states to adopt a law prohibiting any manufacturer, retailer, or distributor of tobacco products to sell or distribute any such product to any individual under the age of 18 and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on buses transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking. On March 31, 2010, President Obama signed into law the Prevent All Cigarette Trafficking (PACT) Act. This legislation, among other things, restricts the sale of tobacco products directly to consumers or unlicensed recipients, including over the Internet, through expanded reporting requirements, requirements for delivery and sales, and penalties.

FSPTCA

The federal Family Smoking Prevention and Tobacco Control Act of 2009 ("**FSPTCA**") (amending the FDA's Food, Drug and Cosmetics Act) ("**FD&C Act**"), signed by President Obama on June 22, 2009, grants the FDA authority to regulate tobacco products. Among other provisions, the FSPTCA:

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

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

- established the collection of user fees from the tobacco industry;
- created and staffed the TPSAC;
- selected the Director of the Center for Tobacco Products;
- announced and began enforcing a ban on fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban);
- issued guidance on registration and product listing;

- issued final rules on tobacco marketing, including restricting access and marketing of cigarettes and smokeless tobacco products to youth;

- issued a prohibition on misleading marketing terms ("Light," "Low," and "Mild") for tobacco products;

- issued a final rule to modify the required warnings that appear on cigarette packages and in cigarette advertisements;

- required warning labels for smokeless tobacco products;

- authorized the sale and marketing of new tobacco products and rejected applications to introduce certain new tobacco products into the market; and

- issued its final rule subjecting e-cigarettes and certain other tobacco products to FDA regulation (as discussed under "E-Cigarettes and Vapor Products" above).

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

Pursuant to requirements of the FSPTCA, the FDA issued a proposed rule in November 2010 to modify the required warnings that appear on cigarette packages and in cigarette advertisements. The proposed new warnings consisted of nine new textual warning statements accompanied by color pictures depicting the negative health consequences of smoking. The proposed warnings would appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50% of these panels, and would also appear in each cigarette advertisement and occupy at least 20% of the advertisement and be located at the top of the advertisement. The FDA took public comments on the proposed rule through January 2011, and in June 2011, the FDA unveiled nine new graphic health warnings that were required to appear on cigarette packages and advertisements no later than September 2012. As discussed below under "*–FSPTCA Litigation*," five tobacco companies in August 2011 filed a complaint against the FDA in the U.S. District Court for the District of Columbia challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The district court enjoined the FDA from enforcing the rule, the appellate court affirmed the district court's decision invalidating the graphic warning rule, and the FDA did not seek further review. The FDA has announced that it would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA and would propose a new graphic warnings rule in the future.

In July 2010, the TPSAC conducted hearings on the impact of dissolvable tobacco products on public health. A report on these hearings was submitted to the FDA in 2011 and remains subject to continuing TPSAC hearings. Written comments regarding dissolvable tobacco products were submitted to the TPSAC ahead of its January 2012 meeting, at which the TPSAC continued its discussions of issues related to the nature and impact of dissolvable tobacco products on public health. The TPSAC's final report released to the FDA in March 2012 found that dissolvable tobacco products would reduce health risks compared to smoking cigarettes, but also have the potential to increase the number of tobacco users. The TPSAC could not reach any overall judgment as to whether or not the consequence of dissolvable tobacco products would be an increase or decrease in the number of people

who successfully quit smoking. The FDA will consider the report and recommendations and determine what future action, if any, is warranted with respect to dissolvable tobacco products. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations.

The TPSAC and the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At its March 2011 meeting, TPSAC presented its report and recommendations on menthol, which included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking non-menthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." At the July 2011 meeting, TPSAC considered revisions to its report, and the voting members unanimously approved the final report for submission to the FDA with no change in its recommendation. On July 23, 2013, the FDA released its Independent Preliminary Scientific Evaluation of the Public Health Effects of Menthol Versus Non-menthol Cigarettes (the "**Preliminary Evaluation**") for public comment, and issued an Advance Notice of Proposed Rulemaking seeking additional information to help the FDA make informed decisions about menthol in cigarettes. The Preliminary Evaluation found that although there is little evidence to suggest menthol cigarettes are more toxic than regular cigarettes, the mint flavor of menthol masks the harshness of tobacco, which makes it easier to become addicted and harder to quit, and increases smoking initiation among youth. The FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. During the public comment period, the FDA was to consider all comments, data and research submitted to determine what regulatory action, if any, with respect to menthol cigarettes is appropriate, including the establishment of product standards. In the meantime the FDA will conduct and support research on the differences between menthol and non-menthol cigarettes as they relate to menthol's likely impact on smoking cessation. The FDA is allowed to rely on the TPSAC's report but is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. See "*FSPTCA Litigation*" below for a description of litigation regarding the composition of the TPSAC and reliance upon the menthol report.

On November 8, 2013, twenty-seven states (including the State) sent a letter to the FDA in support of a ban on menthol-flavored cigarettes. In an August 2016 letter, the African American Tobacco Control Leadership Council asked President Obama to direct the FDA to issue a proposed rule to remove all flavored tobacco products, including mentholated cigarettes, from the marketplace.

Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially with respect to the *Newport* brand mentholated cigarettes, which is now owned by Reynolds American (following the merger with Lorillard, Inc.). According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, the market share of the *Newport* brand as a percentage of the total U.S. cigarette shipments to retail outlets was 13.9% for the period ended September 30, 2016.

In January 2011, the FDA issued guidance concerning reports that manufacturers must submit for certain FDA-regulated tobacco products that the manufacturer modified or introduced for the first time into the market after February 15, 2007. These reports must be reviewed by the FDA to determine if such tobacco products are "substantially equivalent" to products commercially available as of February 15, 2007. In general, in order to continue marketing these products sold before March 22, 2011, manufacturers of FDA-regulated tobacco products were required to send to the FDA a report demonstrating substantial equivalence by March 22, 2011. If the FDA makes a determination that such products were not substantially equivalent, it could require the removal of such products or subject them to the new product application process and, if any such applications are denied, prevent the continued distribution and sale of such products. Manufacturers that intend to introduce new products and certain modified products into the market after March 22, 2011 must submit a report to the FDA and obtain a "substantial equivalence order" from the FDA before introducing the products into the market. If the FDA declines to issue a so-called "substantial equivalence order" for a product or if the manufacturer itself determines that the product does not meet the substantial equivalence requirements, the product would need to undergo the new product application process. In its May 2016 final rule on e-cigarettes and other vapor products, the FDA left the "grandfather" date of February 15, 2007 in place for e-cigarettes and e-vapor products, and any tobacco product that was not legally

marketed as of February 15, 2007 will be considered a new tobacco product subject to premarket review by the FDA. However, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, the FDA has recognized that few, if any, e-cigarettes were on the market as of February 15, 2007, and thousands of such products subsequently entered into commerce, and to address this issue, the FDA established a compliance policy regarding its premarket review requirements for all newly deemed tobacco products that are not grandfathered products, but that are on the market as of August 8, 2016. For these products, the FDA will allow such products to remain on the market so long as the manufacturer has filed the appropriate premarket review application by the applicable deadline (Substantial Equivalence Exemption Report – August 8, 2017; Substantial Equivalence Report – February 8, 2018; and Premarket Tobacco Product Application – August 8, 2018). According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Reynolds American intends to file a Premarket Tobacco Product Application with respect to its VUSE e-cigarette and Reynolds American believes that substantially all other e-cigarette manufacturers will be unable to use the substantial equivalence pathway to obtain FDA clearance but instead will be required to file Premarket Tobacco Product Applications to obtain FDA clearance to market such products. In order for the FDA to clear a Premarket Tobacco Product Application covering an e-cigarette, the manufacturer must show that the marketing of such e-cigarette would be appropriate for the protection of public health, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. The FDA has stated that for any product for which the appropriate premarket review application has been timely filed, the manufacturer may continue to market the product for an additional year from the deadline for filing the appropriate application (i.e., August 8, 2019 for Premarket Tobacco Product Applications) while the FDA reviews the application, and that if the FDA rejects the premarket review application (even if the rejection occurs prior to the end of the one-year period), then the manufacturer must immediately remove that product from commerce, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Since the FSPTCA's enactment, the FDA has received thousands of applications for products that tobacco companies claimed were "substantially equivalent" to ones already on the market. The FDA announced on June 25, 2013 that it approved the applications and authorized the sale of two new non-menthol Newport cigarettes that were made by Lorillard (after determining that the cigarettes, while slightly different than previous products, would not pose new health issues) and rejected four other new tobacco products, based on new health concerns raised by some ingredients and a lack of detail about product design. It was the first instance of a federal agency rejecting an application by a tobacco manufacturer to bring a new tobacco product to the market based on the product's threat to public health. Four additional tobacco products were rejected by the FDA on August 28, 2013 because they were found to be "not substantially equivalent" to the predicate products to which they were compared, and in September 2013 four roll-your-own products were approved for marketing and sale by the FDA because the products were determined to be "substantially equivalent" to the predicate products to which they were compared. In February 2014, the FDA issued orders to prevent the further sale and distribution of four of the "not substantially equivalent" tobacco products that were currently on the market, marking the first time the FDA has used its authority to order a tobacco manufacturer to stop selling and distributing currently available tobacco products. In August 2014, the FDA ordered a tobacco product manufacturer to stop selling and distributing seven dissolvable tobacco products because they were not substantially equivalent to predicate products. According to the FDA, through the end of 2015, the FDA has issued 530 "substantially equivalent" orders, including 435 in 2015, 152 "not substantially equivalent" orders, including 114 in 2015, and 32 "refusal to accept" letters, including 16 in 2015, with respect to substantial equivalence; in addition, 933 reports regarding tobacco products were withdrawn by manufacturers, including 425 in 2015. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that since the FDA began announcing decisions on substantial equivalence reports in 2013, there have been a significant number of substantial equivalence reports for which the FDA has not announced decisions and that at this time it is impossible to predict how long reviews of the FDA of substantial equivalence reports or new product applications will take.

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

On August 27, 2015, the FDA sent a warning letter to Reynolds American's subsidiary Santa Fe Natural Tobacco Company, Inc., claiming that its use of the terms "Natural" and "Additive Free" in the product labeling and advertising for Natural American Spirit cigarettes violates the modified risk tobacco products provision of the

FSPTCA. The FDA stated that in order for such terms to be used, these cigarettes must have an FDA modified-risk tobacco product order, which requires scientific evidence in order to legally make those claims. According to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Santa Fe Natural Tobacco Company, Inc. has not modified the product labeling or advertising for that brand since the receipt of the FDA's warning letter, but the FDA could in the future take a variety of enforcement actions against the manufacturer, including forcing recalls from the market, requiring deleting or substantially modifying such phrases and imposing penalties, if the FDA were to determine that the use of such phrases violates the FSPTCA.

In March 2015 and September 2015, the FDA issued draft guidance that announced that certain label changes and changes to the quantity of tobacco products in a package would each require submission of substantial equivalence reports and authorization from the FDA prior to marketing tobacco products with such changes, even when the tobacco product itself is not changed. As discussed under "—*FSPTCA Litigation*" below, in response to a legal challenge from the tobacco manufacturers, a court found that labeling changes do not require a substantial equivalence review, but product quantity changes require a substantial equivalence review.

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

- require manufacturers to test ingredients and constituents identified by the FDA and disclose this information to the public;
- prohibit use of tobacco containing a pesticide chemical residue at a level greater than allowed under Federal law;
- establish "good manufacturing practices" to be followed at tobacco manufacturing facilities;
- authorize the FDA to place more severe restrictions on the advertising, marketing and sale of tobacco products;
- permit inconsistent state regulation of labeling and advertising and eliminate the existing federal preemption of such regulation;
- authorize the FDA to require the reduction of nicotine (though not to zero) and the reduction or elimination of other constituents; and
- grant the FDA the regulatory authority to impose broad additional restrictions.

The FSPTCA imposes fees on tobacco product manufacturers and importers to pay for the cost of regulation and other matters. The fees are allocated first among tobacco product categories subject to FDA regulation and then among manufacturers and importers within certain categories based on their market share. The fees are also subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the FDA has a number of investigatory and enforcement tools available as discussed herein under "–*Federal Regulation*." Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that compliance with such regulatory requirements has resulted and will continue to result in additional costs and that although the amount of additional compliance and related costs has not been material in any given quarter or year to date, such compliance could become material, either individually or in the aggregate, to one or more of its tobacco subsidiaries.

FSPTCA Litigation

Tobacco manufacturers have filed suit regarding certain provisions of the FSPTCA and actions taken thereunder. In August 2009, a group of tobacco manufacturers (including Reynolds Tobacco and Lorillard) and a tobacco retailer filed a complaint against the U.S. government in the U.S. District Court for the Western District of Kentucky, *Commonwealth Brands, Inc. v. U.S.*, 678 F.Supp.2d 512, in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the

Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. Plaintiffs sought a preliminary injunction and a judgment declaring the challenged provisions unconstitutional. Both plaintiffs and the government filed motions for summary judgment and on November 5, 2009, the district court denied certain plaintiffs' motion for preliminary injunction as to the modified risk tobacco products provision of the FSPTCA and in January 2010 granted partial summary judgment to plaintiffs on their claims that the ban on color and graphics in advertising and the ban on statements implying that tobacco products are safer due to FDA regulation violated their First Amendment speech rights. The district court granted partial summary judgment to the government on all other claims. Both parties appealed from the district court's order and on March 19, 2012, the U.S. Court of Appeals for the Sixth Circuit affirmed the district court's decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. The Sixth Circuit further affirmed the district court's grant of summary judgment to plaintiff manufacturers on the unconstitutionality of the FSPTCA's restriction of tobacco advertising to black and white text. The Sixth Circuit reversed the district court's determination that the FSPTCA's restriction on statements regarding the relative safety of tobacco products based on FDA regulation is unconstitutional and its determination that the FSPTCA's ban on tobacco continuity programs is permissible under the First Amendment. On May 31, 2012, the Sixth Circuit denied the plaintiffs' motion for rehearing en banc. On October 30, 2012, the plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. On April 22, 2013, the U.S. Supreme Court denied plaintiffs' petition for certiorari. The government had not appealed the portion of the Court of Appeals ruling that affirmed the unconstitutionality of the FSPTCA's restriction of tobacco advertising to black and white text.

In a separate lawsuit that challenged the constitutionality of the FDA regulation that restricts tobacco manufacturers from using the trade or brand name of a non-tobacco product on cigarettes or smokeless tobacco products, the case was dismissed without prejudice pursuant to a stipulation by which the FDA agreed not to enforce the current or any amended trade name rule against plaintiffs until at least 180 days after rulemaking on the amended rule concludes. This relief only applies to plaintiffs in the case. However, in May 2010, the FDA issued guidance on the use of non-tobacco trade and brand names applicable to all cigarette and smokeless tobacco product manufacturers. This guidance indicated the FDA's intention not to commence enforcement actions under the regulation while it considers how to address the concerns raised by various manufacturers. In November 2011, the FDA proposed an amended rule, but has not yet issued a final rule, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In February 2011, Lorillard, along with Reynolds Tobacco, filed a lawsuit in the U.S. District Court for the District of Columbia, *Lorillard, Inc. v. U.S. Food and Drug Administration*, against the FDA challenging the composition of the TPSAC because of the FDA's appointment of certain voting members with significant financial conflicts of interest. Lorillard believed these members were financially biased because they regularly testify as expert witnesses against tobacco-product manufacturers, and because they are paid consultants for pharmaceutical companies that develop and market smoking-cessation products. The suit similarly challenged the presence of certain conflicted individuals on the Constituents Subcommittee of the TPSAC. The complaint sought a judgment (i) declaring that, among other things, the appointment of the conflicted individuals to the TPSAC (and its Constituents Subcommittee) was arbitrary, capricious, an abuse of discretion, and otherwise not in compliance with the law because it prevented the TPSAC from preparing a report that was unbiased and untainted by conflicts of interest, and (ii) enjoining the FDA from, among other things, relying on the TPSAC's report. On July 21, 2014, the U.S. District Court for the District of Columbia granted plaintiffs' summary judgment motion, in part, and denied defendants' summary judgment motion, finding that three of the panel's members had conflicts of interest that biased them against the tobacco industry and that "the FDA's appointment of those members was arbitrary and capricious, in violation of the APA, and fatally tainted the composition of the TPSAC and its work product, including the Menthol Report." The court ordered the FDA to reconstitute the TPSAC so that it complies with the applicable ethics laws and barred the FDA from relying on the TPSAC 2011 report on menthol, which the court found to be, "at a minimum suspect, and at worst untrustworthy." The FDA appealed the district court's decision to the U.S. Court of Appeals for the District of Columbia in September 2014. On March 5, 2015, the FDA announced the resignation or termination of four members from the TPSAC and the addition of three members to the TPSAC, in response to the district court's order to reconstitute the committee. The FDA also announced that it would work expeditiously to fill the remaining vacancy. On January 15, 2016, the appellate court reversed the decision of the district court, finding that the plaintiffs did not have standing to challenge appointments of certain TPSAC members. Under the appellate court's order, the three former committee members can serve once again on the TPSAC and the

FDA can rely on the TPSAC menthol report. On February 26, 2016, the plaintiff tobacco manufacturers filed a petition for a rehearing en banc, which was denied in May 2016.

On August 16, 2011, five tobacco companies (including OPMs Reynolds Tobacco and Lorillard as well as SPMs Commonwealth Brands, Inc., Liggett Group LLC, and Santa Fe Natural Tobacco Company, Inc.) filed a complaint against the FDA in the U.S. District Court for the District of Columbia, *R.J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration*, challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The tobacco companies sought a declaratory judgment that the FDA's final rule violates the First Amendment and the Administrative Procedure Act (the "**APA**"), and declarative and injunctive relief that the new textual and graphic warnings will not become effective until 15 months after the FDA issues regulations "that are permissible under the United States Constitution and federal laws." The plaintiffs alleged that the FDA's final rule regarding textual and graphic warnings requires them "to become a mouthpiece for the Government's emotionally-charged anti-smoking message." The plaintiffs also contended that the FDA's warnings are unjustified and unduly burdensome, as they do not further any compelling governmental purpose and are "unlikely to have any material impact on consumer understanding of smoking risks, consumer intentions regarding smoking, or actual consumer smoking decisions." The FDA's final rule, according to the plaintiffs, "violates the First Amendment under any standard of review." On February 29, 2012, the district court granted the plaintiffs' motion for summary judgment and entered an order permanently enjoining the FDA, until 15 months following the issuance of new regulations implementing Section 201(a) of the FSPTCA that are substantively and procedurally valid and permissible under the United States Constitution and federal law, from enforcing against plaintiffs the new textual and graphic warnings required by Section 201 (a) of the FSPTCA. The district court ruled that the mandatory graphic warnings violated the First Amendment by unconstitutionally compelling speech, and that the FDA had failed to carry both its burden of demonstrating a compelling interest for its rule requiring the textual and graphic warning labels and its burden of demonstrating that the rule is narrowly tailored to achieve a constitutionally permissible form of compelled commercial speech. The FDA filed an appeal with the U.S. Court of Appeals for the District of Columbia Circuit on March 4, 2012, and moved the appellate court to consolidate this appeal with the FDA's appeal of the preliminary injunction decision. The Court of Appeals granted the FDA's motion and heard argument on both appeals on April 10, 2012. On August 24, 2012, the Court of Appeals affirmed the district court's decision invalidating the graphic warning rule. On October 9, 2012, the FDA filed a motion for rehearing en banc with the Court of Appeals, and on December 5, 2012, the Court of Appeals denied the FDA's petition for a rehearing en banc. The FDA, on December 5, 2012, issued a notice announcing its intention to collect information from consumers to determine the effectiveness of graphic warning labels, in apparent response to the Court of Appeal's August 2012 affirmation of the invalidation of the graphic warning rule, in which it cited the absence of evidence that the chosen labels furthered the FDA's stated goal of encouraging cessation and discouraging initiation of smoking. On March 19, 2013, the FDA announced that it would not file a petition for a *writ of certiorari* with the U.S. Supreme Court, but instead would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA and would propose a new graphic warnings rule in the future. The FDA has not provided a timeline for a new rule. In October 2016, several public health groups filed suit in federal court to force the FDA to issue final rules requiring graphic warnings on cigarette packs and advertising.

In March 2015, the FDA issued draft guidance that announced that certain label changes and changes to the quantity of tobacco products in a package would each require submission of substantial equivalence reports and authorization from the FDA prior to marketing tobacco products with such changes, even when the tobacco product itself is not changed. Philip Morris and other tobacco manufacturers filed a lawsuit in the U.S. District Court for the District of Columbia against the FDA and the U.S. Department of Health and Human Services seeking to declare the new requirements invalid and to enjoin their enforcement. In May of 2015, the FDA announced that it would not enforce the requirements under the new guidance as it continued to consider comments it received. On September 8, 2015, the FDA issued a second version of the guidance which continues to require FDA pre-authorization for certain label changes and product quantity changes. On September 30, 2015, Philip Morris and other manufacturers filed a new lawsuit U.S. District Court for the District of Columbia against the same defendants as in the prior suit seeking to declare the requirements of the revised guidance invalid and to enjoin their enforcement. In October 2015, plaintiffs filed a motion for summary judgment and the defendants opposed the motion for summary judgment and moved to dismiss the complaint in December 2015. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, in August 2016 the court granted summary judgment for the plaintiff tobacco manufacturers on the issue of labeling changes, finding that such changes do not require a substantial equivalence review, but found that product quantity changes do require a substantial equivalence review.

The parties did not appeal the decision, thereby concluding the litigation, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Surgeon General Reports

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

In June 2006, the Office of the Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke." It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. On September 18, 2007, the Office of the Surgeon General released the report, "Children and Secondhand Smoke Exposure", which concludes that many children are exposed to secondhand smoke in the home and that establishing a completely smoke-free home is the only way to eliminate secondhand smoke exposure in that setting. The Surgeon General also addressed the health risks of second-hand smoke in its 2010 report entitled "How Tobacco Smoke Can Cause Disease: The Biology and Behavioral Basis for Smoking-Attributable Disease." In 2012, the Surgeon General released a report on preventing tobacco use among youth and young adults, and on January 17, 2014, the Surgeon General released a report on the health consequences of smoking, contending that smoking is linked to a higher number of deaths to Americans than previous estimates, that filtered cigarettes may increase the risk of certain diseases, and that cigarettes are a causal factor in certain conditions and diseases that had not previously been linked to cigarette smoking. These reports are expected to strengthen arguments in favor of further smoking restrictions across the country.

Other Federal Action

In October 2011, the FDA and the National Institutes of Health (the "**NIH**") announced a joint national study called the "Tobacco Control Act National Longitudinal Study of Tobacco Users" to monitor and assess the behavioral and health impacts of new government tobacco regulations by following approximately 60,000 users of tobacco products and those who are 12 and over who are at risk of using tobacco products. The study is being coordinated by researchers at the NIH's National Institute on Drug Abuse and the FDA's Center for Tobacco Products. According to the NIH, data is expected to be collected between 2013 and 2016. The results of the study will be used to guide the FDA in targeting effective actions to reduce the effects of smoking on public health.

In November 2011, the FDA announced its plans for an integrated anti-smoking campaign that targets teenagers, with a combined budget of up to $600 million over five years. As part of this campaign, the FDA announced in February 2014 that advertisements would run for at least one year under the $115 million "Real Cost" campaign that targets young people aged 12-17 years and shows the costs and health consequences associated with tobacco use. According to the FDA, subsequent campaigns will target young adults aged 18-24 years and people who influence teens, including parents, family members and peers. The FDA has reported that it is conducting a multi-year evaluation to assess how well the campaign is reaching its goals and to identify places where it might refine its messages. Other audiences of special interest that are planned to be targeted in future campaigns include minorities, gays, people with disabilities, the military, pregnant women, people living in rural areas, and low-income people.

In March 2012, the CDC announced its first national anti-tobacco effort entitled "Tips From Former Smokers" (TIPS) which features graphic advertisements intended to shock smokers into quitting with stories of people damaged by tobacco products. The initial campaign's goal was to convince 500,000 people to try quitting smoking and 50,000 to quit long-term, and the CDC reported that as a result of the 2012 campaign an estimated 1.6 million smokers attempted to quit smoking and more than 200,000 Americans had quit smoking immediately following the campaign, of which researchers estimated that more than 100,000 would likely quit smoking permanently, according to the CDC. The TIPS advertising campaign was subsequently renewed in March of 2013,

July of 2014 and March of 2015 with new advertisements showing in stark terms the negative health effects of smoking. The CDC announced the launch of another graphic anti-smoking campaign to begin January 25, 2016, to run for 20 weeks on television, radio, billboards online and in magazines and newspapers. The CDC has reported that the TIPS program helped prompt millions of smokers to try to quit since it began in 2012. Annual budgets of the CDC have consistently included funds for tobacco prevention and control, including in order to continue the national tobacco education campaigns that are meant to raise awareness about the health effects of tobacco use and prompt smokers to quit.

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

It has been reported that the U.S. Defense Department is making a concerted effort to reduce smoking among its members, and in June 2014 it formed an advisory committee to explore avenues for a reduction in smoking. A March 14, 2014 Defense Department memo encourages the services to eliminate tobacco sales and tobacco use on military bases, although it does not order specific actions. In July 2014, the Senate Appropriations defense subcommittee approved a defense spending bill that would eliminate the 25% discount that members of the armed services enjoy when buying tobacco products at commissaries and elsewhere.

Excise Taxes

Cigarettes are subject to substantial excise taxes in the U.S. On February 4, 2009, President Obama signed into law, effective April 1, 2009, an increase of $0.62 in the excise tax per pack of cigarettes, bringing the total federal excise tax to $1.01 per pack, and significant tax increases on other tobacco products. The federal excise tax rate for snuff increased $0.925 per pound to $1.51 per pound. The federal excise tax on small cigars, defined as those weighing three pounds or less per thousand, increased by $48.502 per thousand to $50.33 per thousand. In addition, the federal excise tax rate for roll-your-own tobacco increased from $1.097 per pound to $24.78 per pound. Press reports have noted that many consumers who previously purchased roll-your-own tobacco began using pipe tobacco to roll their own cigarettes in order to avoid the new excise tax, as pipe tobacco excise taxes were unaffected, and using new, mechanized rolling machines to process cigarettes in bulk. Press reports have also noted that increased excise taxes have led to an increase in cigarette smuggling. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as a result of the tax disparity between cigarettes and loose tobacco created by the 2009 federal excise tax increase, the number of retailers selling loose tobacco and operating roll-your-own machines, allowing consumers to convert the loose tobacco into finished cigarettes, greatly increased. On July 6, 2012, President Obama signed into law a provision classifying retailers that operate roll-your-own machines as cigarette manufacturers, thus requiring those retailers to pay the same tax rate as other cigarette manufacturers. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016, 26 states also had passed legislation classifying retailers operating roll-your-own machines as cigarette manufacturers. President Obama's 2017 federal budget

proposal, released in early February 2016, includes a proposed increase in the federal excise tax on a pack of cigarettes to $1.95 per pack (and proposed proportionate increases in all other tobacco product tax rates).

All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2015 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to a report by the American Lung Association, in 2009, 14 states turned to cigarette taxes to increase revenue in response to record state deficits. As reported by Reynolds American's SEC filings and the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), six states passed cigarette excise tax increases during 2010, two states (Connecticut and Vermont) passed cigarette excise tax increases during 2011, and in 2012, Illinois and Rhode Island enacted legislation to increase their cigarette excise taxes. Altria has reported that during 2013, Massachusetts, Minnesota, Oregon and Puerto Rico had enacted legislation to increase their cigarette taxes. In particular, Minnesota increased its cigarette excise tax in July 2013 by $1.60 per pack, and Massachusetts raised its excise tax by $1.00 per pack, effective July 31, 2013, bringing its tax to $3.51 per pack, the second highest in the country after New York. New Hampshire's cigarette tax also increased by $0.10 on August 1, 2013 due to legislation enacted in 2011. Vermont enacted a cigarette excise tax increase in 2014. During 2015, Alabama, Nevada, Kansas, Vermont, Louisiana, Ohio, Rhode Island and Connecticut enacted legislation to increase their cigarette excise taxes, according to Reynolds American in its SEC filings. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, during the first nine months of 2016, 19 states proposed legislation to increase cigarette excise taxes, with legislation being enacted in three states (Louisiana, Pennsylvania and West Virginia) and failing in 16 states. In California, a proposal to increase the State's cigarette excise tax by $2.00 per pack (in addition to that state's current $0.87 per pack excise tax) is on the ballot for November 2016.

According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.39. In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold such as New York, Philadelphia and Chicago.

Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that between the end of 1998 (the year in which the MSA was executed) and October 24, 2016, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.61 per pack. It is expected that states and local governments will continue to raise excise taxes on cigarettes in 2016 and future years.

All 50 states and the District of Columbia subject smokeless tobacco to excise taxes (with Pennsylvania being the last state to do so, effective October 1, 2016). According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, during the first nine months of 2016, 14 states proposed legislation to increase existing excise taxes on smokeless tobacco products, with such legislation passing in one state (West Virginia), failing in 11 states and remaining pending, as of September 30, 2016, in two states. As set forth above under "E-Cigarettes and Vapor Products", according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016, five states and the District of Columbia imposed a tax on vapor products, and a sixth state, Pennsylvania, imposed a tax on vapor products effective October 1, 2016.

According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, six states require NPMs to pay a fee on each pack of cigarettes sold in their respective states, ranging from $0.25 per pack in Alaska to $0.55 per pack in Texas (as discussed below). In 2004, Michigan imposed an equity assessment on NPMs selling cigarettes in that state. The purpose of the equity assessment is to fund enforcement and administration of Michigan's Qualifying Statute and Complementary Legislation. The assessment is required to be prepaid by March 1 of each year for all cigarettes that are anticipated to be sold in Michigan in the current calendar year. For each NPM, the prepayment amount is equal to the greater of (i) $10,000 or (ii) the number of cigarettes that the Department of Treasury reasonably determines that the NPM will sell in Michigan in the current calendar year multiplied by 17.5 mills. According to SLATI, Two Previously Settled States, Minnesota and Mississippi, also impose a fee on tobacco product manufacturers that have not signed such states' Previously Settled State Settlements: in Minnesota, a fee of $0.50 per pack of 20 cigarettes is imposed on non-settling

manufacturers; and in Mississippi, a fee of $0.27 (adjusted for inflation each year) per pack of 20 cigarettes is imposed on non-settling manufacturers. In addition, Texas (a Previously Settled State) enacted legislation in June 2013 to apply a fee of $0.55 per pack for future health costs to tobacco manufacturers that did not join Texas' State Settlement Agreement. The tax took effect on September 1, 2013, but in November 2013, a district court judge in *Texas Small Tobacco Coalition. v. Combs* (Tex. Dist. Ct., Travis Cnty.) ruled that the tax violated the Equal and Uniform Taxation clause of the Texas Constitution. The Texas Comptroller of Public Accounts appealed this decision on November 13, 2013, and on August 15, 2014 the Texas Court of Appeals affirmed the district court judge's decision, holding that the tax violates the Texas Constitution, and enjoined Texas from collecting or assessing the tax. The State of Texas filed its petition for review with the Texas Supreme Court in October 2014, and on April 1, 2016, the Texas Supreme Court reversed the Texas Court of Appeals and ruled that the Texas equity fee legislation does not violate the Texas Constitution and remanded the case back to the Texas Court of Appeals for that court to consider the non-settling manufacturers' remaining challenges to the legislation. On June 20, 2016, plaintiffs filed a motion for rehearing with the Texas Supreme Court, which motion was denied, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. See "RISK FACTORS—Payment Decreases Under the Terms of the MSA."

In 2005, Minnesota enacted a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold, in order to recover Minnesota's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies (and in February 2007, the U.S. Supreme Court denied Philip Morris's petition for writ of certiorari). In 2013, however, the Minnesota legislature repealed the health impact fee (the bill cited the contemporaneous increase in the cigarette excise tax as offsetting the repeal of the health impact fee).

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

Minimum Age to Possess or Purchase Tobacco Products

All states and the District of Columbia have enacted laws generally prohibiting the sale of tobacco products to individuals under the age of 18. Several jurisdictions have recently passed legislation, and other jurisdictions are considering proposals, to raise the minimum age for the purchase of tobacco products. The minimum age to purchase tobacco products rose to 21 in the State of Hawaii as of January 1, 2016 (the first state to do so) and in California in June 2016. According to the Campaign for Tobacco-Free Kids, at least 200 localities have raised the tobacco age to 21, including New York City, Chicago, Boston, Cleveland and both Kansas Cities. According to the IHS Global Consumption Report, proposals to raise the minimum age to 21 have been introduced in Colorado, Massachusetts, Missouri, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Utah, Vermont, and Washington. Four states, Alabama, Alaska, New Jersey, and Utah currently set the minimum age at 19, according to SLATI. On March 12, 2015, the Institute of Medicine of the National Academy of Sciences released a report recommending that the minimum age of legal access to tobacco products be raised to 21. The report concluded that raising the minimum legal age to 21 would likely decrease smoking prevalence by 12% among today's teenagers when they become adults.

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

State and Local Regulation

Legislation imposing various restrictions on public smoking has been enacted in all of the states and many local jurisdictions. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund either anti-smoking programs, healthcare programs or cancer research. In addition, educational and

research programs addressing healthcare issues related to smoking are being funded from industry payments made or to be made under the MSA.

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

In addition to the FSPTCA disclosure requirements and marketing and labeling restrictions, several states have enacted or proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes to state health authorities. According to SLATI, six states currently require some form of tobacco product disclosure information, including, for example, requiring tobacco manufacturers to disclose any added constituent of tobacco products other than tobacco, water and reconstituted tobacco sheet made wholly from tobacco (Massachusetts and Texas); requiring disclosure of the nicotine yield for each brand of cigarettes (Massachusetts, Texas and Utah); and requiring tobacco manufacturers to disclose the presence of ammonia, any compound of ammonia, arsenic, cadmium, formaldehyde or lead in their unburned or burned states (Minnesota and Utah).

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

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

According to ANRF, as of October 1, 2016, 40 states and territories have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars (and only 15 states and territories do not have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars, being Alabama, Alaska, Arkansas, Georgia, Guam (however, effective January 1, 2017, Guam will require 100% smoke-free restaurants and bars), Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee, Texas, Virginia, West Virginia and Wyoming). On September 4, 2014, Kentucky banned all uses of tobacco products on most government properties. Also according to ANRF, as of October 1, 2016, 27 states have laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars: Arizona, California, Delaware, Hawaii, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, New York, North Dakota, Ohio, Oregon, Puerto Rico, Rhode Island, South Dakota, the U.S. Virgin Islands, Utah, Vermont, Washington and Wisconsin. Restrictions in many jurisdictions also include a ban on outdoor smoking within a specified number of feet of the entrances of restaurants and other public places. ANRF also tracks clean indoor air ordinances by local governments throughout the U.S. Most states without a statewide smoking ban have some local municipalities that have enacted smoking regulations. As of October 1, 2016, there were 1,320 municipalities with local laws that require 100% smoke-free non-hospitality workplaces or restaurants or bars, of which 846 municipalities (including the District of Columbia) have local laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars. In addition, according to ANRF, as of October 1, 2016, there are at least 782 state-regulated gambling facilities that are required to be 100% smokefree indoors, and there are at least 613 smokefree airports. It is expected that restrictions on indoor smoking will continue to proliferate.

Smoking bans have also extended outdoors. For example, according to ANRF, as of October 1, 2016:

- Puerto Rico prohibits smoking on beaches, Maine prohibits smoking on beaches in its state parks, and 273 municipalities specified that all city beaches and/or specifically named city beaches are smoke-free;

- Oklahoma prohibits tobacco and e-cigarette use on all state lands, Puerto Rico prohibits smoking in all parks, and 1,292 municipalities specified that all city parks and/or specifically named city parks are smoke-free; in addition, on March 31, 2016, New York's highest court upheld a smoking ban in certain outdoor areas, state parks and historic sites;

- Hawaii, Maine, Michigan, Washington and Puerto Rico laws prohibit smoking in both outdoor dining areas and bar patios (while Iowa prohibits smoking only in outdoor dining areas), and 407 municipalities have enacted laws for 100% smoke-free outdoor dining, while 244 municipalities have enacted laws for 100% smoke-free outdoor dining areas and bar patios; and

- Iowa, New York, Wisconsin, Guam and the U.S. Virgin Islands prohibit smoking in outdoor public transit waiting areas, and there are 469 municipalities with smoke-free outdoor public transit waiting area laws.

Smoking bans have also been enacted for smaller governmental and private entities. According to the ANRF, as of October 1, 2016, there are at least 1,713 100% smoke-free university and college campuses, and of these, 1,427 have a 100% tobacco-free policy and 1,288 prohibit the use of e-cigarettes anywhere on campus. The University of California implemented its system-wide smoke-free and tobacco-free policy effective January 1, 2014. ANRF further reports, as of October 1, 2016, that four national hospitals, clinics, insurers and health service companies, and at least 3,940 local and/or state hospitals, healthcare systems and clinics have adopted 100% smokefree grounds policies; that in July 2013 New York State enacted a law requiring 100% smokefree grounds of general hospitals; in April 2016, Hawaii enacted a law requiring 100% tobacco- and e-cigarette-free grounds of state health facility properties; and that 40 municipalities have enacted laws specifically requiring 100% smokefree hospital grounds. In addition, ANRF reports as of October 1, 2016 that the Federal Bureau of Prisons prohibits the smoking of tobacco in any form in and on the grounds of its institutions and offices, that correctional facilities in 21 states plus Puerto Rico are 100% smokefree indoors and outdoors, and that 28 other states ban smoking indoors in correctional facilities but allow smoking in outdoor areas. ANRF reports that as of October 1, 2016, five states and 174 municipalities have laws requiring that all hotel and motel rooms be 100% smoke-free. Furthermore, ANRF reports as of October 1, 2016 that 52 municipalities restrict or prohibit smoking in private units of market-rate multi-unit housing (whether privately-owned or publicly-owned housing), and 429 municipalities have smokefree policies for publicly-owned multi-unit housing.

Voluntary Private Sector Regulation

In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace and providing incentives to employees who do not smoke, including charging higher health insurance premiums to employees who smoke and refusing to hire people who do smoke, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans. According to the IHS Global Consumption Report, New York City's first non-smoking apartment building opened in 2009, and many landlords and condominium associations in California and New York City have also established smoke-free apartment policies, including Related Companies, which manages 40,000 rental units across the country and announced in June 2013 a ban on smoking in all its apartments across the country.

International Agreements

On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control the ("**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to

youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force in February 2005 and according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of October 24, 2016, 179 countries and the European Community have become party to the FCTC. In November 2012, parties to the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products, which was open for signature between January 2013 and January 2014. While the United States is a signatory of the FCTC, it is not currently a party to the agreement, as the agreement has not been submitted to, or ratified by, the United States Senate.

Civil Litigation

Overview

Legal proceedings or claims covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against the tobacco industry. Several types of claims are raised in these proceedings including, but not limited to, claims for product liability, consumer protection, antitrust, and reimbursement. Litigation is subject to many uncertainties and it is possible that there could be material adverse developments in pending or future cases. Damages claimed in some tobacco-related and other litigation are or can be significant and, in certain cases, range in the billions of dollars. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could materially adversely affect the business of the PMs and the market for or prices of securities such as the Series 2017 Bonds payable from tobacco settlement payments made under the MSA.

Thousands of claims have been brought against the PMs in tobacco-related litigation. According to Reynolds American and Altria in their respective Forms 10-Q filed with the SEC for the nine-month period ended September 30, 2016, the following tobacco-related cases were pending against Reynolds American and its subsidiaries (including Reynolds Tobacco and Lorillard), and against Altria and its subsidiary Philip Morris, respectively: individual smoker cases pending in West Virginia state court as a consolidated action (see "West Virginia Individual Personal Injury Cases" below)—approximately 564 against Reynolds American and its subsidiaries, and 344 against Philip Morris; *Engle* Progeny cases (see "*Engle* Progeny Cases" below)— 2,888 cases involving approximately 3,755 individual plaintiffs against Reynolds American and its subsidiaries, and approximately 2,700 state court cases involving approximately 3,600 state court plaintiffs against Altria and Philip Morris (plus 14 *Engle* Progeny Cases pending in federal court against Altria and Philip Morris); 2,421 flight attendant cases (see "Flight Attendant Cases" below) against Reynolds American and its subsidiaries and 2,493 against Altria and Philip Morris; among other cases pending against such OPMs.

Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that after exhausting all appeals in cases resulting in adverse verdicts associated with tobacco-related litigation, since October 2004 Philip Morris has paid in the aggregate judgments (and related costs and fees) totaling approximately $428 million and interest totaling approximately $183 million as of October 24, 2016. Reynolds American reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that Reynolds Tobacco as of September 30, 2016 had paid approximately $223 million since January 1, 2014 related to unfavorable smoking and health litigation judgments.

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

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

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

Type of Case

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

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

West Virginia Individual Personal Injury Cases. In a 1999 administrative order, the West Virginia Supreme Court of Appeals transferred to a single West Virginia court a group of cases brought by individuals who allege cancer or other health effects caused by smoking cigarettes, smoking cigars, or using smokeless tobacco products (the "**West Virginia Cases**"). The plaintiffs' claims alleging injury from smoking cigarettes were consolidated for trial. The plaintiffs' claims alleging injury from the use of other tobacco products have been severed from the consolidated cigarette claims and have not been consolidated for trial. The time for filing a case that could be consolidated for trial with the West Virginia Cases expired in 2000.

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

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

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

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

Individual Smoking and Health Cases

This category of cases includes smoking and health cases alleging personal injury that are brought by or on behalf of individual plaintiffs, but does not include the West Virginia Cases, *Engle* Progeny Cases or Flight Attendant Cases discussed below.

An example of an Individual Smoking and Health Case brought against Philip Morris is *Schwarz*. In March 2002, an Oregon jury awarded $168,500 in compensatory damages and $150 million in punitive damages against Philip Morris, and in May 2002 the trial court reduced the punitive damages award to $100 million. In May

2006, the Oregon Court of Appeals affirmed the compensatory damages verdict, 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 2010, the Oregon Supreme Court affirmed the court of appeals' decision and remanded the case to the trial court for a new trial limited to the question of punitive damages. In February 2012, the jury awarded the plaintiff $25 million in punitive damages, and in July 2015, the Oregon Court of Appeals affirmed the judgment in favor of plaintiff. Philip Morris filed a petition for review with the Oregon Supreme Court, which the court denied in November 2015, and on February 10, 2016 Philip Morris filed a petition for writ of certiorari with the United States Supreme Court, which the Court denied in May 2016. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Philip Morris paid the final judgment in June 2016 plus interest and associated costs of approximately $34 million, concluding this litigation.

An example of an Individual Smoking and Health Case brought against Reynolds Tobacco is *Izzarelli v. R. J. Reynolds Tobacco Co.*, a case filed in December 1999 in the U.S. District Court for the District of Connecticut. In May 2010, the jury returned a verdict in favor of the plaintiff, who sought to recover damages for personal injuries allegedly sustained as a result of unsafe and unreasonably dangerous cigarette products, finding Reynolds Tobacco to be 58% at fault and the plaintiff to be 42% at fault. Final judgment was entered in December 2010 in the amount of $11.95 million in favor of the plaintiff, which included $3.97 million in punitive damages. In September 2013, the Court of Appeals for the Second Circuit certified to the Connecticut Supreme Court the question of whether the comments to the Restatement (Second) of Torts preclude a suit premised on strict products liability against a cigarette manufacturer based on evidence that the defendant purposefully manufactured cigarettes to increase daily consumption without regard to the resultant increase in exposure to carcinogens, but in the absence of evidence of any adulteration or contamination. In April 2016, the Connecticut Supreme Court ruled that tobacco plaintiffs could bring a strict liability claim if they were arguing cigarettes were designed to be more addictive, and that such claims would not be impacted by the so-called "good tobacco" exception (which holds tobacco products cannot generally be considered defective unless adulterated or contaminated). According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, in July 2016 the Second Circuit ordered another round of briefing to be submitted after the Connecticut Supreme Court decides the questions certified to it in another case (where a decision remains pending) that raises certain issues of Connecticut product liability law that are also presented in *Izzarelli*.

Another example of an Individual Smoking and Health Case currently pending is *Larkin v. R. J. Reynolds Tobacco Co.*, a case filed in January 2002 in the Circuit Court, Miami-Dade County, Florida, in which the plaintiff alleged that as a result of using the defendant's products, the decedent suffered from mouth and lung cancer, and sought an unspecified amount of compensatory and punitive damages. In July 2015, the jury returned a verdict in favor of the plaintiff, found the decedent 38% at fault and Reynolds Tobacco 62% at fault. Final judgment was entered in the amount of approximately $13.46 million in July 2015. According to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, in March 2016 the court granted Reynolds Tobacco's motion for a new trial on claims of defective product and damages only and denied the remaining post-trial motions, and the new trial has not been scheduled. In addition, in April 2016, Reynolds Tobacco appealed to the Third District Court of Appeal, the plaintiff cross appealed, and briefing is underway, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

West Virginia Cases

The West Virginia Cases began in 1999, in West Virginia state court, as a series of roughly 1,200 individual plaintiff cases making claims with respect to cigarettes manufactured by Philip Morris, Lorillard, Reynolds Tobacco and other manufacturers. The cases were consolidated for a Phase I trial on various defense conduct issues, to be followed in Phase II by individual trials of remaining claims. On May 15, 2013, the Phase I jury found that defendants' cigarettes were not defectively designed; defendants' cigarettes were not defective due to a failure to warn before July 1, 1969; defendants were not negligent, did not breach warranties, and did not engage in conduct warranting punitive damages; and defendants' ventilated filter cigarettes manufactured and sold between 1964 and July 1, 1969 were defective for a failure to instruct. In November 2014, the West Virginia Supreme Court affirmed the verdict. On June 8, 2015, the U.S. Supreme Court denied the plaintiffs' petition for writ of certiorari. On the same date, the trial court issued an order finding that only 30 plaintiffs are alleged to have smoked ventilated filter cigarettes in the relevant period. On October 9, 2015, the trial court outlined the procedures it will follow for resolving the claims of the 30 Phase II plaintiffs, which claims will focus on whether plaintiffs blocked cigarette

vents and, if so, whether blocking proximately caused their alleged injuries. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, five cases were selected to be the first claims tried, and they were tentatively scheduled to be tried beginning on May 1, 2017. In June 2016, the court granted the defendants' motion to compel and required the plaintiffs to file additional expert disclosures necessary to attempt to proceed with their claims, and the court will set a revised discovery and trial schedule after the expert disclosures are tested for admissibility, and it pushed the tentative trial date to May 2018, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In addition to the foregoing claims, various plaintiffs in 1999 and 2000 asserted claims against retailers and distributors. Those claims were severed and stayed pending the outcome of Phase I. Also, 41 plaintiffs asserted smokeless tobacco claims against various smokeless manufacturers. Those claims were severed in 2001, and the plaintiffs took no action to prosecute the claims. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, the plaintiffs seek to activate their smokeless claims, and the defendant tobacco manufacturers have moved to dismiss those claims since the plaintiffs took no action to prosecute them for 15 years.

Engle Progeny Cases

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

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

In the wake of the Florida Supreme Court ruling, thousands of individuals filed separate lawsuits seeking to benefit from the *Engle* findings. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of October 24, 2016, 102 federal and state *Engle* Progeny Cases involving Philip Morris have resulted in verdicts since the Florida Supreme Court's *Engle* decision, 56 of which were returned in favor of plaintiffs, 3 of which were initially returned in favor of the plaintiffs but were reversed on appeal and remain pending, and 43 of which were returned in favor of Philip Morris. In addition, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of October 24, 2016 approximately 2,700 state court cases were pending against Philip Morris or Altria asserting individual claims by or on behalf of approximately 3,600 state court plaintiffs, and 14 cases were pending against Philip Morris in federal court representing the federal cases excluded from the settlement agreement discussed below. According to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, as of September 30, 2016 Reynolds Tobacco, Lorillard and other Reynolds American affiliates were defendants in 2,888 pending *Engle* Progeny Cases, including approximately 3,755 plaintiffs, in both state courts (2,874 cases) and federal courts (14 cases) in Florida (most federal cases were settled as discussed below). Reynolds American also reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that as of September 30, 2016 verdicts or judgments in favor of *Engle* progeny plaintiffs have been entered and remain outstanding against Reynolds Tobacco or Lorillard totaling approximately $196.1 million in compensatory damages (as adjusted) and

$197.4 million in punitive damages, and such verdicts or judgments are at various stages in the post-trial or appellate process.

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

In February 2015, Philip Morris, Reynolds Tobacco and Lorillard settled virtually all of the *Engle* Progeny Cases then pending against them in federal district court. The total amount of the settlement of the federal *Engle* Progeny Cases was $100 million, divided among Reynolds Tobacco ($42.5 million), Philip Morris ($42.5 million) and Lorillard ($15 million), which shares of the settlement were paid into escrow in March 2015. The settlement, which received final approval from the court on November 6, 2015, covers more than 400 federal *Engle* Progeny Cases but does not cover certain federal *Engle* Progeny Cases previously tried to verdict and pending on post-trial motions or appeal, or filed by different lawyers from the ones who negotiated the settlement for the plaintiffs. Also, certain state court cases were removed from state to federal court, which were not part of the settlement, and were all remanded back to state court, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

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

In addition to the global due process argument, the tobacco manufacturers raise many other factual and legal defenses as appropriate in each case. According to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, these defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker's own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny Cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff's motion for rehearing en banc and vacated the panel decision. On March 23, 2016, the Eleventh Circuit requested briefing on the issues of whether the plaintiff's claims are preempted and, if not, whether the defendants' due process rights are violated. Oral argument occurred on June 21, 2016, and a decision is pending, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Florida Fourth District Court of Appeal disagreed with the *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of plaintiffs in *Engle* Progeny Cases. The Florida Supreme Court has accepted jurisdiction in *Marotta*, and oral argument was scheduled for November 1, 2016, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In addition, in *Searcy*, an *Engle* Progeny Case against Philip Morris and Reynolds Tobacco on appeal to the Eleventh Circuit, defendants argued that application of the *Engle* findings to the *Engle* progeny plaintiffs' concealment and conspiracy claims violated defendants' due process rights; the appeal is pending, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. In *Soffer*, an *Engle*

Progeny Case against Reynolds Tobacco, the Florida First District Court of Appeal held that *Engle* progeny plaintiffs can recover punitive damages only on their intentional tort claims; the Florida Supreme Court accepted jurisdiction over plaintiff's appeal from the Florida First District Court of Appeal's decision and, in March 2016, held that *Engle* progeny plaintiffs can recover punitive damages in connection with all of their claims, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. Plaintiffs have increasingly relied on this Florida Supreme Court decision at the trial and appellate court levels in seeking punitive damages in connection with all of their claims, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. In *Ciccone*, an *Engle* Progeny Case against Reynolds Tobacco, the Florida Fourth District Court of Appeal held that *Engle* progeny plaintiffs could establish class membership by showing that they developed symptoms during the *Engle* class period that could, in hindsight, be attributed to their smoking-related disease. The court certified a conflict with *Castleman*, a Florida First District Court of Appeal decision, which held that manifestation requires *Engle* progeny plaintiffs to have been aware during the class period that they had a disease caused by smoking in order to establish class membership. The Florida Supreme Court accepted jurisdiction in the *Ciccone* case and, in March 2016, ruled in favor of the plaintiff, approving the Fourth District Court of Appeal's definition, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In one of the pending *Engle* Progeny Cases in which each of Philip Morris, Reynolds Tobacco and Lorillard are defendants, *Calloway v. R.J. Reynolds Tobacco Company, et al.* (Circuit Court, Seventeenth Judicial Circuit, Broward County, Florida), the jury awarded plaintiff and a daughter of the decedent a total of $20,500,000 in compensatory damages. The jury apportioned 20.5% of the fault for the smoker's injuries to the smoker, 27% to Reynolds Tobacco, 25% to Philip Morris, 18% to Lorillard, and 9.5% to Liggett. The jury awarded a total punitive damages award from the defendants of $54,850,000. In August 2012, the court granted a post-trial motion by the defendants and lowered the compensatory damages award to $16,100,000. The court also ruled that the jury's finding on the plaintiff's percentage of comparative fault would not be applied to reduce the compensatory damage award because the jury found in favor of the plaintiff on her claims alleging intentional conduct. In August 2012, the court entered final judgment against defendants in the amount of $16,100,000 in compensatory damages and $54,850,000 in punitive damages, plus the statutory rate of interest. On January 6, 2016, the Florida Fourth District Court of Appeal reversed the fraudulent concealment and conspiracy claims, reversed the punitive damages award, and remanded the case for a new trial on those issues. On September 23, 2016, the Fourth District Court of Appeal, sitting en banc, reversed the judgment in its entirety and remanded the case for a new trial; the new trial has not been scheduled, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. In October 2016, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In another pending *Engle* Progeny Case, *Naugle v. Philip Morris*, a jury returned a verdict in November 2009 in favor of the plaintiff and against Philip Morris. The jury awarded approximately $56.6 million in compensatory damages and $244 million in punitive damages, allocating 90% of the fault to Philip Morris. In August 2010, the trial court entered an amended final judgment of approximately $12.3 million in compensatory damages and approximately $24.5 million in punitive damages. In June 2012, the Fourth District Court of Appeal affirmed the amended final judgment, and in July 2012, Philip Morris filed a motion for rehearing. In December 2012, the Fourth District withdrew its prior decision, reversed the verdict as to compensatory and punitive damages and returned the case to the trial court for a new trial on the question of damages. Upon retrial on the question of damages, on October 16, 2013, the new jury awarded approximately $3.7 million in compensatory damages and $7.5 million in punitive damages. On May 16, 2014, Philip Morris filed a notice of appeal to the Fourth District Court of Appeal. On January 6, 2016, the Fourth District Court of Appeal reversed the trial court's decision and remanded the case to the trial court to conduct a juror interview. In April 2016, Philip Morris moved for a new trial following the juror interview, which the court denied, and in May 2016, Philip Morris filed a notice of appeal to the Fourth District Court of Appeal, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

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

2014 to set aside the jury's verdict on the grounds that it was unconstitutionally disproportionate to plaintiff's actual damages. The court entered partial judgment on the compensatory damages against Reynolds Tobacco in the amount of $16.9 million on July 21, 2014. On January 27, 2015 the court denied the defendant's post-trial motions, but granted the defendant's motion for remittitur of the punitive damages award. The punitive damages award was remitted to approximately $16.9 million. In February 2015, Reynolds Tobacco filed an objection to the remitted award of punitive damages and a demand for a new trial on damages. The court granted a new trial on the amount of punitive damages only. The new trial on punitive damages has been stayed, and Reynolds Tobacco filed a notice of appeal to the First District Court of Appeal of the partial judgment of compensatory damages and of the order granting a new trial on the amount of punitive damages only. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, Reynolds Tobacco posted a supersedeas bond in the amount of $5 million, briefing on the merits is complete, oral argument occurred on May 24, 2016, and a decision is pending.

In *Ryan v. R.J. Reynolds Tobacco Co.*, an *Engle* Progeny Case first filed in August 2007 in the Circuit Court, Broward County, Florida, the jury in a retrial in April 2015 returned a verdict in favor of the plaintiff, found the plaintiff to be 35% at fault and Reynolds Tobacco to be 65% at fault and awarded $21.5 million in compensatory damages and $25 million in punitive damages. In May 2015, Reynolds Tobacco filed its post-trial motions, and final judgment was entered against Reynolds Tobacco in the amount of $21.5 million in compensatory damages and $25 million in punitive damages. On April 29, 2016, the court entered an amended final judgment against Reynolds Tobacco in the amount of approximately $14 million in compensatory damages and $25 million in punitive damages. Reynolds Tobacco filed a notice of appeal to the Fourth District Court of Appeal and posted a supersedeas bond in the amount of $5 million on May 27, 2016; briefing is underway, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In *Hubbird v. R. J. Reynolds Tobacco Co.* (Cir. Ct. Miami-Dade County, Fla., filed 2008), in August 2014 a jury found for the plaintiff on the negligence, strict liability, and intentional torts claims, awarded $3 million in compensatory damages, found the decedent 50% at fault and Reynolds Tobacco 50% at fault, and found that the plaintiff was entitled to punitive damages, which the jury awarded in the amount of $25 million. Reynolds Tobacco appealed, and on June 1, 2016, the Third District Court of Appeal affirmed the final judgment, per curiam. On September 1, 2016, Reynolds Tobacco paid approximately $30.5 million in satisfaction of the judgment, according to Reynolds American's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

A number of *Engle* Progeny Cases have been placed on courts' upcoming trial calendars. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, there are approximately 194 *Engle* Progeny Cases against Reynolds Tobacco, B&W and/or Lorillard set for trial through September 30, 2017 (but it is not known how many of these cases will actually be tried). Trial schedules are subject to change.

In June 2009, Florida amended its existing bond cap statute by adding a $200 million bond cap that applied to all *Engle* Progeny Cases in the aggregate. In May 2011, Florida removed the provision that would have allowed it to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny Case varies depending on the number of judgments in effect at a given time, but never exceeds $5 million per case. The legislation, which became effective in June 2009 and 2011, applies to judgments entered after the original 2009 effective date. The plaintiffs in some cases challenged the constitutionality of the amended statute. These motions were denied, withdrawn or declared moot. In January 2012, the Florida Supreme Court agreed to review one of the orders denying a challenge to the amended statute. In August 2012, the Florida Supreme Court dismissed the appeal as moot because the defendant had satisfied the judgment.

Various *Engle* Progeny Cases in addition to the cases described herein are discussed in detail in the SEC filings of Altria and Reynolds American.

Flight Attendant Cases

Four cigarette manufacturers are the defendants in the pending Flight Attendant Cases. These suits were filed as a result of a settlement agreement by the parties in *Broin v. Philip Morris Companies, Inc., et al.* (Circuit Court, Miami-Dade County, Florida, filed October 31, 1991), a class action brought on behalf of flight attendants

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

According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, there were 2,421 Flight Attendant Cases pending in Florida, and there have been no trials of Flight Attendant Cases since 2007.

Class Action Cases

In most of the class action cases, plaintiffs seek class certification on behalf of groups of cigarette smokers, or the estates of deceased cigarette smokers, who reside in the state in which the case is filed. Several categories of class-action cases are discussed below.

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

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

Since the December 2008 United States Supreme Court decision in *Good*, and through October 24, 2016, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, 26 purported "Lights" class actions were served upon Philip Morris and, in certain cases, Altria. These cases were filed in 15 states, the U.S. Virgin Islands and the District of Columbia. All of these cases either were filed in federal court or were removed to federal court by Philip Morris and were transferred and consolidated by the Judicial Panel on Multidistrict Litigation ("**JPMDL**") before the United States District Court for the District of Maine for pretrial proceedings. In November 2010, the district court denied plaintiffs' motion for class certification in four cases, covering the jurisdictions of California, the District of Columbia, Illinois and Maine. These jurisdictions were selected by the parties as sample cases, with two selected by plaintiffs and two selected by defendants. Plaintiffs sought appellate review of this decision but, in February 2011, the United States Court of Appeals for the First Circuit denied plaintiffs' petition for leave to appeal. Later that year, plaintiffs in 13 cases voluntarily dismissed without prejudice their cases. In April 2012, the JPMDL remanded the remaining four cases back to the federal

district courts in which the suits originated, and these cases were ultimately resolved in a manner favorable to Philip Morris, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. As of October 24, 2016, in addition to the JPMDL proceeding, 20 courts in 21 "lights" Class Action Cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or entered judgment in favor of Philip Morris, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. State trial courts have certified classes against defendant tobacco manufacturers in several jurisdictions; over time, several such cases have been dismissed by the courts at the summary judgment stage, but others remain pending, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

The Price Case. In *Price, et al v. Philip Morris Inc*. (Circuit Court, Madison County, Illinois, filed February 10, 2000) the trial judge found in favor of the plaintiff class and awarded $7.1 billion in compensatory damages and $3 billion in punitive damages against Philip Morris in 2003. In December 2005, the Illinois Supreme Court issued its judgment reversing the trial court's judgment in favor of the plaintiffs and directing the trial court to dismiss the case. In December 2006, the defendant's motion to dismiss and for entry of final judgment was granted, and the case was dismissed with prejudice. In December 2008, plaintiffs filed with the trial court a petition for relief from the final judgment and sought to vacate the 2005 Illinois Supreme Court judgment, contending that the U.S. Supreme Court's December 2008 decision in *Good* demonstrated that the Illinois Supreme Court's decision was "inaccurate." In February 2009, the trial court granted Philip Morris's motion to dismiss plaintiffs' petition. In March 2009, the plaintiffs filed a notice of appeal with the Illinois Appellate Court, Fifth Judicial District. In February 2011, the Illinois Appellate Court, Fifth Judicial District reversed the trial court's dismissal of plaintiffs' petition and remanded for further proceedings, and on September 28, 2011, the Illinois Supreme Court denied Philip Morris' petition for leave to appeal that ruling. As a result, the case returned to the trial court for proceedings on whether the court should grant the plaintiffs' petition to reopen the prior judgment. In February 2012, plaintiffs filed an amended petition, which Philip Morris opposed. Subsequently, in responding to Philip Morris's opposition to the amended petition, plaintiffs asked the trial court to reinstate the original judgment. On December 12, 2012, the trial court denied the plaintiffs' request to reopen the prior judgment, and the plaintiffs filed a notice of appeal to the Fifth District Appellate Court on January 8, 2013. On April 29, 2014, the Fifth District Appellate Court reinstated the $10.1 billion 2003 verdict. In May 2014, Philip Morris filed a petition requesting the Illinois Supreme Court to direct the Fifth Judicial District to vacate its April 2014 judgment and to order the Fifth Judicial District to affirm the trial court's denial of the plaintiff's petition for relief from the judgment, or in the alternative, grant its petition for leave to appeal. On September 24, 2014, the Illinois Supreme Court agreed to hear Philip Morris's appeal. In November 2015, the Illinois Supreme Court vacated the judgments of the lower courts and dismissed the case without prejudice to allow the plaintiffs to file a motion to recall the mandate. The plaintiffs filed a motion to recall the mandate or for other appropriate relief in the Illinois Supreme Court, which was denied on January 11, 2016. In January 2016 plaintiffs filed a petition for writ of certiorari with the United States Supreme Court on the question of whether one of the Illinois Supreme Court justices should have recused himself, and in June 2016 the U.S. Supreme Court denied plaintiffs' petition for writ of certiorari.

In another "Lights" Class Action Case, *Larsen v. Philip Morris Inc*. (formerly *Craft v. Philip Morris Inc.*), a Missouri Court of Appeals in August 2005 affirmed a class certification order for current and former smokers of Marlboro Lights. (The class period is 1995 through 2003.) Plaintiffs sought nearly $2 billion in damages. In June 2011, Philip Morris filed various summary judgment motions challenging the plaintiffs' claims. In August 2011, the trial court granted Philip Morris's motion for partial summary judgment, ruling that plaintiffs could not present a damages claim based on allegations that Marlboro Lights are more dangerous than Marlboro Reds, and denied Philip Morris's remaining summary judgment motions. Trial began in September 2011, and in October 2011 the trial court declared a mistrial after the jury failed to reach a verdict. In January 2014, the trial court reversed its prior ruling granting partial summary judgment against plaintiffs' "more dangerous" claim and allowed plaintiffs to pursue that claim. In October 2014, Philip Morris filed motions to decertify the class and for partial summary judgment on the plaintiffs' "more dangerous" claim, which the court denied in June 2015. Upon retrial, in April 2016, the jury returned a verdict in favor of Philip Morris, and in May 2016, plaintiffs filed a motion for a new trial, which Philip Morris opposed in June 2016. In August 2016, the trial court denied the plaintiffs' motion for a new trial, the plaintiffs filed a notice of appeal and Philip Morris cross-appealed, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

In November 2013, an Arkansas trial court approved class certification in a Marlboro Lights lawsuit, *Miner et al v. Philip Morris Cos. Inc*. Plaintiffs initially filed the lawsuit against Philip Morris in 2003, accusing the company of deceptive marketing practices in violation of the Arkansas Deceptive Business Practices Act. Plaintiffs alleged that Philip Morris violated the law by advertising Marlboro Lights as a safer alternative to regular cigarettes. Philip Morris filed a notice of appeal of the class certification ruling to the Arkansas Supreme Court in December 2013. In February 2015, the Arkansas Supreme Court affirmed the trial court's class certification order. In May 2015, Philip Morris filed a motion for partial summary judgment seeking to foreclose any recovery for cigarette purchases prior to 1999, when a private right of action was added to the consumer protection statute under which plaintiffs are suing. The trial court denied the motion in July 2015. In June 2016, the trial court granted Philip Morris's motion for partial summary judgment to limit any damages claimed by the plaintiffs' class to purchases made prior to May 2003. In July 2016, the parties agreed to settle all claims for $45 million, and the settlement was preliminarily approved by the trial court in August 2016 and is subject to final approval by the court., according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

On June 19, 2013, the Oregon Court of Appeals in *Pearson et al. v. Philip Morris Inc.* et al. reversed a Multnomah County Circuit judge's October 2005 decision that had granted summary judgment to Philip Morris and had dismissed a lawsuit filed against Philip Morris in 2002 by two Marlboro Lights smokers. The Court of Appeals ruled that plaintiffs' claims were not preempted by federal law as the circuit court had concluded and were not subject to dismissal on that basis. The Court of Appeals also ruled that the circuit court had erred in not allowing the case to proceed as a class-action suit on behalf of an alleged 100,000 Oregon smokers, and remanded the case to the trial court for further consideration of class certification. The plaintiffs alleged, among other things, that Philip Morris violated the Oregon Unlawful Trade Practices Act by misrepresenting the tar and nicotine characteristics of Marlboro Lights and that, as result of such misrepresentations, plaintiffs had suffered economic losses. In July 2013, Philip Morris filed a petition for reconsideration with the Oregon Court of Appeals, which was denied in August 2013. Philip Morris filed its petition for review to the Oregon Supreme Court in October 2013, which the court accepted in January 2014. In October 2015, the Oregon Supreme Court affirmed the trial court's order denying class certification, thereby reversing the decision of the Oregon Court of Appeals. On November 5, 2015, plaintiffs filed a motion for reconsideration with the Oregon Supreme Court, which the court denied. In December 2015, the Oregon Supreme Court entered its judgment denying class certification and remanding the claims of the individual plaintiffs for further proceedings. In April 2016, the parties agreed to settle plaintiffs' individual claims for an aggregate amount of $30,000 and, pursuant to that settlement, the parties filed a stipulation of voluntary dismissal with prejudice with the Circuit Court of Multnomah County, concluding the litigation, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Medical Monitoring Class Action Cases. In medical monitoring actions, plaintiffs seek to recover the cost for, or otherwise the implementation of, court-supervised programs for ongoing medical monitoring purportedly on behalf of a class of individual plaintiffs. Plaintiffs in these cases seek to impose liability under various product-based causes of action and the creation of a court-supervised program providing members of the purported class low dose CT scanning in order to identify and diagnose lung cancer.

In one of the class actions, *Scott v. The American Tobacco Company, et al.* (District Court, Orleans Parish, Louisiana, filed May 24, 1996), a class was certified on behalf of certain cigarette smokers resident in the State of Louisiana who desired to participate in medical monitoring or smoking cessation programs and who began smoking prior to September 1, 1988, or who began smoking prior to May 24, 1996 and alleged that defendants undermined compliance with the warnings on cigarette packages. In *Scott*, trial was heard in two phases and at the conclusion of the first phase in July 2003, the jury rejected medical monitoring, the primary relief requested by plaintiffs, and returned sufficient findings in favor of the class to proceed to a Phase II trial on plaintiffs' request for a statewide smoking cessation program. Phase II of the trial, which concluded in May 2004, resulted in an award of $591 million to fund cessation programs for Louisiana smokers. In February 2007, the Louisiana Court of Appeal reduced the amount of the award by approximately $300 million; struck an award of prejudgment interest, which totaled approximately $440 million as of December 31, 2006; and limited class membership to individuals who began smoking by September 1, 1988, and whose claims accrued by September 1, 1988. The case was returned to the trial court, which subsequently entered an amended final judgment that ordered the defendants to pay approximately $264 million to fund a ten year, court-supervised smoking cessation program for the members of the certified class. The Louisiana Court of Appeal, Fourth Circuit, issued a decision in April 2010 that modified the trial court's 2008 amended final judgment, reducing the judgment amount to approximately $242 million to fund the

court-supervised smoking cessation program. Both the Louisiana Supreme Court and the U.S. Supreme Court declined to review the case. In August 2011, following the exhaustion of all appeals, the defendants paid a total of approximately $280 million to satisfy the final judgment and the interest that was due.

In addition to the *Scott* case, other purported medical monitoring class actions have been brought by plaintiffs. In one case, *Donovan v. Philip Morris*, the Supreme Judicial Court of Massachusetts, in answering questions certified to it by the district court, held in October 2009 that under certain circumstances state law recognizes a claim by individual smokers for medical monitoring despite the absence of an actual injury. The case was remanded to federal court for further proceedings. In June 2010, the district court granted in part the plaintiffs' motion for class certification, certifying the class as to plaintiffs' claims for breach of implied warranty and violation of the Massachusetts Consumer Protection Act, but denying certification as to plaintiffs' negligence claim. In July 2010, Philip Morris petitioned the U.S. Court of Appeals for the First Circuit for appellate review of the class certification decision. The petition was denied in September 2010. As a remedy, plaintiffs proposed a 28-year medical monitoring program with an approximate cost of $190 million. In June 2011, plaintiffs filed various motions for summary judgment and to strike affirmative defenses, which the district court denied in March 2012 without prejudice. In October 2011, Philip Morris filed a motion for class decertification, which motion was denied in March 2012. In February 2013, the district court amended the class definition to extend to individuals who satisfy the class membership criteria through February 26, 2013, and to exclude any individual who was not a Massachusetts resident as of February 26, 2013. In July 2015, both parties filed various motions, including motions for partial summary judgment and to exclude certain evidence. In October 2015, the district court granted Philip Morris's motion for partial summary judgment holding that e-vapor products may not be deemed an alternative design for ordinary cigarettes. In February 2016, the trial court jury returned a verdict in favor of Philip Morris on the warranty claim. In March 2016, Philip Morris filed a motion for judgment on plaintiffs' Massachusetts Consumer Protection Act claim based on the jury's verdict, which the court denied in April 2016, ruling that it would function as the finder of fact with respect to the Massachusetts Consumer Protection Act. In September 2016, the U.S. District Court for the District of Massachusetts ruled in favor of Philip Morris on the plaintiffs' Massachusetts Consumer Protection Act claim and entered final judgment in favor of Philip Morris, and the plaintiff did not appeal the judgment, thereby concluding the litigation, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Other Class Action Cases. According to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, several e-cigarette class-action cases are pending against Reynolds American and its affiliates in California. In general, the plaintiffs allege that defendants made false and misleading claims that e-cigarettes are less hazardous than other cigarette products or failed to disclose that e-cigarettes expose users to certain substances. The cases are typically filed pursuant to state consumer protection and related statutes and seek injunctive relief, equitable relief, and compensatory and punitive damages, according to Reynolds American.

In addition, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, following the FDA's August 27, 2015 warning letter to Reynolds American's subsidiary Santa Fe Natural Tobacco Company, Inc. relating to the use of the words "natural" and "additive-free" in the labeling, advertising, and promotional materials for Natural American Spirit brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative class actions against Reynolds American and Santa Fe Natural Tobacco Company, Inc. A total of 15 such actions have been filed in nine U.S. district courts, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. In various combinations, plaintiffs in these cases generally allege violations of state deceptive and unfair trade practice statutes, and claim state common law fraud, negligent misrepresentation, and unjust enrichment based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of Natural American Spirit brand cigarettes. The actions seek various categories of recovery, including economic damages, injunctive relief (including medical monitoring and cessation programs), interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. On January 6, 2016, the plaintiffs in one action filed a motion before the JPMDL to consolidate these actions before one district court for pretrial purposes. On April 11, 2016, the JPMDL ordered that these cases be consolidated for pretrial purposes in the U.S. District Court for the District of New Mexico, and the then-pending and later-filed cases now are consolidated for pretrial purposes in that court, according to Reynolds American in its

Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. The court's scheduling order provides for the defendants to file motions to dismiss by November 3, 2016, a hearing on the defendants' motion to dismiss on January 24, 2017, plaintiffs to file a motion for class certification by April 3, 2018, and a hearing on the class certification motion on July 13-14, 2018, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Health-Care Cost Recovery Cases

Health-Care Cost Recovery Cases are brought by or on behalf of entities seeking equitable relief and reimbursement of expenses incurred in providing health care to individuals who allegedly were injured by smoking. Plaintiffs in these cases have included the U.S. federal government, U.S. state and local governments, foreign governmental entities, hospitals or hospital districts, American Indian tribes, labor unions, private companies and private citizens. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The claims asserted include the claim that cigarette manufacturers were "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking, as well as claims of indemnity, negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal and state anti-racketeering statutes.

According to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016, although there have been some decisions to the contrary, most judicial decisions in the U.S. have dismissed all or most health-care cost recovery claims against cigarette manufacturers; nine federal circuit courts of appeals and eight state appellate courts, relying primarily on grounds that plaintiffs' claims were too remote, have ordered or affirmed dismissals of health-care cost recovery actions, and the U.S. Supreme Court has refused to consider plaintiffs' appeals from the cases decided by five circuit courts of appeals.

The *DOJ* Case. In 1999, in *United States v. Philip Morris USA Inc.*, the U.S. Department of Justice brought an action against various tobacco manufacturers in the U.S. District Court for the District of Columbia. The government initially sought to recover federal funds expended by the federal government in providing health care to smokers who developed diseases and injuries alleged to be smoking-related, based on several federal statutes. In addition, the government sought, pursuant to the civil provisions of RICO, disgorgement of profits the government contended were earned as a consequence of a RICO racketeering "enterprise." In September 2000, the district court dismissed the government's claims asserted under the Medical Care Recovery Act as well as those under the Medicare Secondary Payer provisions of the Social Security Act, but did not dismiss the RICO claims. In February 2005, the Circuit Court of Appeals for the District of Columbia ruled that disgorgement is not an available remedy in the case. The government's petition for writ of certiorari with the U.S. Supreme Court was denied in October 2005. The non-jury, bench trial concluded in June 2005, and in August 2006, the U.S. District Court for the District of Columbia issued its final judgment and remedial order in favor of the government. The court determined that the defendants violated certain provisions of the RICO statute, that there was a likelihood of present and future RICO violations, and that equitable relief was warranted. The government was not awarded monetary damages.

The equitable relief included permanent injunctions that prohibit the defendant tobacco manufacturers from engaging in any act of racketeering, as defined under RICO; from making any material false or deceptive statements concerning cigarettes; from making any express or implied statement about health on cigarette packaging or promotional materials (these prohibitions include a ban on using such descriptors as "low tar," "light," "ultra-light," "mild" or "natural"); from making any statements that "low tar," "light," "ultra-light," "mild" or "natural" or low-nicotine cigarettes may result in a reduced risk of disease; and from participating in the management or control of certain entities or their successors. The final judgment and remedial order also requires the defendants to make corrective statements on their websites, in certain media, in point-of-sale advertisements, and on cigarette package "onserts" (as described below). In addition, the final judgment and remedial order requires defendants to make disclosures of disaggregated marketing data to the government, and to make document disclosures on a website and in a physical depository, and also prohibits each defendant that manufactures cigarettes from selling any of its cigarette brands or certain elements of its business unless certain conditions are met.

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

On November 27, 2012 the U.S. District Court for the District of Columbia issued an order specifying the text of the corrective statements that the defendants must make on their websites and through other media. The court ordered that the corrective statements include statements, among others, to the effect that smoking kills on average 1,200 Americans every day, results in various detrimental health conditions and is highly addictive, that low tar and light cigarettes are not less harmful than regular cigarettes and cause some of the same detrimental health conditions that regular cigarettes cause, that tobacco companies intentionally designed cigarettes to make them more addictive, and that secondhand smoke causes lung cancer and coronary heart disease in adults who do not smoke. The court further ordered that the parties are to engage in discussions with the court, regarding implementation of the corrective statements. In January 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements, claiming a violation of free speech rights. Defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements, which the Court of Appeals granted in February 2013.

On January 10, 2014, the U.S. government and the defendant tobacco companies issued a joint status report confirming that the parties reached an agreement following the negotiations regarding implementation of the corrective statements and filed a joint motion for consent order. For specified time periods following the date when all appeals are exhausted, corrective statements would be disseminated in newspapers (print and online), on television, on the tobacco companies' websites, and on "onserts" affixed to cigarette packs. In April 2014, the parties filed an amended proposed consent order and accompanying submission in the district court seeking entry of a revised agreement on the implementation details of the corrective communications remedy. The consent order as revised by the parties provided that the parties thereto do not waive or abandon any appeal or appellate rights or argument and that defendants reserve the right to challenge on appeal the content of the court-ordered corrective statements and the requirement that the court-ordered corrective statements appear in the multiple media referenced in the court's remedial order and in the consent order. The consent order further provided that defendants will not challenge on appeal the specific implementation executions in the consent order, that plaintiffs will not invoke defendants' agreement to the specific implementation executions in response to defendants' appellate challenge to the court-ordered corrective statements, and that should the language of the corrective statements be changed as a result of further litigation, the parties reserve the right to seek different requirements than those in the consent order. In addition, the consent order stays implementation until the exhaustion of the defendants' appeal challenging the constitutionality of the corrective statements. In June 2014, U.S. District Court for the District of Columbia approved the April 2014 proposed consent order. However, the June 2014 consent order did not resolve outstanding issues as to whether corrective statements must be posted in retail point-of-sale displays.

In May 2015, the U.S. Court of Appeals affirmed in part and reversed in part the consolidated appeal before it, and upheld the content of the corrective statements ordered by the district court in November 2012, but rejected the preamble to the statements (which had included a statement that the PMs deliberately deceived the American

public). The Court of Appeals remanded the case to the trial court for further proceedings. In July 2015, the government filed a petition for panel rehearing, which the U.S. Court of Appeals denied in August 2015. In October 2015, the district court ordered further briefing on the content of the preamble to the statements and any implementation changes the parties propose.

On June 30, 2015, the district court held a status conference to discuss briefing and scheduling of future submissions in light of the Court of Appeals' decision on the corrective statement issue. On July 7, 2015, the U.S. Department of Justice filed a motion for rehearing with the Court of Appeals, which was denied on August 5, 2015. On August 20, 2015, the district court directed the parties to undertake mediation in order to attempt to reach agreement on the wording of the corrective-statements preamble. The parties were unable to reach agreement. On October 1, 2015, the district court held a status conference at which it ordered the parties to propose new corrective-statements preambles and brief their proposals in October and November 2015. The U.S. Department of Justice proposed a preamble that removed the reference to deliberate deception, and instead included only that a federal court has ordered the PMs to make such corrective statements. On February 8, 2016, the district court issued an order on the content of the corrective-statements preamble. In the order, the district court held that the preamble proposed by the Department of Justice remedied the concern of the Court of Appeals, and the district court adopted the corrective statements set forth in the order, with the preamble that the government had proposed. The court also ordered the parties to submit proposed changes to the consent order on the implementation details, which the parties jointly submitted and the court approved in April 2016. Also in April 2016, defendants filed a notice of appeal to the U.S. Court of Appeals for the District of Columbia Circuit on the content of the corrective communications, and in May 2016, defendants filed a notice of appeal of the consent order for the purpose of perfecting the appeal of the district court's February 2016 order on the content of the corrective communications, according to Altria in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016. Briefing in the consolidated appeals will conclude in late December 2016, according to Reynolds American in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016.

Altria stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that in the second quarter of 2014, Altria and Philip Morris recorded provisions on each of their respective balance sheets totaling $31 million for the estimated costs of implementing the corrective communications remedy, and Reynolds American stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2016 that $20 million has been accrued for the estimated costs of the corrective communications and is included in the consolidated balance sheet as of September 30, 2016.

Other Litigation

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

Defenses

The PMs have stated that they believe that they have valid defenses to the cases pending against them as well as valid bases for appeal should any adverse verdicts be returned against them. While PMs have indicated their intent to defend vigorously all tobacco products liability litigation, it is not possible to predict the outcome of any litigation. Litigation is subject to many uncertainties. Plaintiffs have prevailed in several cases, as noted herein, and it is possible that one or more of the pending actions could be decided unfavorably as to the PMs or the other defendants. The PMs may enter into discussions in an attempt to settle particular cases if the PMs believe it is appropriate to do so.

Some plaintiffs have been awarded damages from cigarette manufacturers at trial. While some of these awards have been overturned or reduced, other damages awards have been paid after the manufacturers have

exhausted their appeals. These awards and other litigation activities against cigarette manufacturers and health issues related to tobacco products also continue to receive media attention. It is possible, for example, that the 2006 verdict in the DOJ case, which made many adverse findings regarding the conduct of the defendants, could form the basis of allegations by other plaintiffs or additional judicial findings against cigarette manufacturers. In addition, the U.S. Supreme Court ruling in *Good v. Altria* could result in further "lights" litigation. Any such developments could have material adverse effects on the ability of the PMs to prevail in smoking and health litigation and could influence the filing of new suits against the PMs. The type or extent of litigation that could be brought against PMs in the future cannot be predicted.

The foregoing discussion of civil litigation against the domestic tobacco industry is not exhaustive and is not based upon the examination or analysis by TSASC of the court records of the cases mentioned or of any other court records. It is based on SEC filings by the OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2017 Bonds are referred to the reports filed with the SEC by the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filings, Reynolds American has stated that the possibility of material losses related to tobacco litigation is more than remote, but that generally, it is not possible to predict the outcome of the litigation or reasonably estimate the amount or range of any possible loss. This OPM has disclosed that notwithstanding the quality of defenses available to it and its affiliates in tobacco-related litigation matters, it is possible that its consolidated results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending or future litigation matters or difficulties in obtaining the bonds required to stay execution of judgments on appeal. It can be expected that at any time and from time to time there will be developments in the litigation currently pending and filing of new litigation that could materially adversely affect the business of the PMs and the market for or prices of securities such as the Series 2017 Bonds payable from tobacco settlement payments made by the PMs under the MSA.

IHS GLOBAL CONSUMPTION REPORT

The following is a brief summary of the IHS Global Consumption Report, a copy of which is attached hereto as APPENDIX A-1. This summary does not purport to be complete and the IHS Global 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 IHS Global 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 as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. IHS Global's forecasts, including, but not limited to, regarding future cigarette consumption, are estimates, which have been prepared by IHS Global on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of and no representation or warranty should be inferred from, these forecasts. The cigarette consumption forecast contained in the IHS Global Consumption Report is based upon assumptions as to future events and, accordingly, is subject to varying degrees of uncertainty. Some assumptions inevitably will not materialize and, additionally, unanticipated events and circumstances may occur. Therefore, for example, actual cigarette consumption inevitably will vary from the forecast included in the IHS Global Consumption Report and the variations may be material and adverse. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2017 Bonds will be as assumed. See "RISK FACTORS" herein.

General

IHS Global Inc. ("**IHS Global**") has prepared a report dated November 7, 2016 on the consumption of cigarettes in the United States from 2016 through 2052 entitled, "*A Forecast of U.S. Cigarette Consumption (2016-2052) for TSASC, Inc.*" ("**IHS Global Consumption Report**"). IHS Global is an internationally recognized econometric and forecasting firm with over 600 economists located in more than 30 countries. IHS Global is a subsidiary of IHS, Inc., a publicly traded company on the New York Stock Exchange (NYSE: IHS). IHS is a leading source of information, insight and advisory services in the areas of economics, energy, chemicals, technology, transportation, healthcare, geopolitical risk, sustainability and supply chain management.

IHS Global has developed an econometric model of cigarette consumption in the United States based on historical United States data between 1965 and 2015, and what IHS Global describes as widely accepted economic principles and IHS Global's experience in building econometric forecasting models. IHS Global considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, health warnings, and the availability of alternative tobacco and nicotine products. After determining which variables were effective in building this cigarette consumption model (including real cigarette prices, real per capita disposable personable income, the impact of workplace smoking restrictions, stricter restrictions on smoking in public places, and the trend over time in individual behavior and preferences), IHS Global employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and per capita cigarette consumption in the United States.

IHS Global's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2016 through 2052 (the "**IHS Global Consumption Forecast**"). The IHS Global Consumption Forecast indicates that the total consumption of cigarettes in the United States is projected to fall annually at a rate of 3.0% from 2016 through 2052, resulting in a forecast of total U.S. cigarette consumption in 2052 to be 88.2 billion cigarettes (a 67% decline from the 2015 level), as set forth in the IHS Global Consumption Report. The IHS Global Consumption Report states that IHS Global believes the assumptions on which the IHS Global Consumption Forecast is based are reasonable.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco, Firearms and Explosives) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980s, 1990s and 2000s, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2003 and under 300 billion in 2011. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.2% between 1965 and 1981. Between 1981 and 1990, however, U.S. cigarette consumption declined at an average annual rate of 2.2%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.5%; but for 1998 the decline increased to 3.1% and increased further to 6.5% for 1999. These declines are correlated with large price increases in 1998 and 1999 following the MSA and the Previously Settled States Settlements. In 2000 and 2001, the rate of decline moderated, to 1.2%. Coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an average annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%.

The rate of decline accelerated dramatically in 2008 through 2010 (due to indoor smoking bans, recession and the increases in the federal and state excise taxes), before finally decelerating in 2011 and 2012. In 2013 the decline sharpened to nearly 5%. This decline has been attributed by the industry to a weak economy, the rapid increase in usage of electronic cigarettes, and to an unfavorable comparison with a surprisingly strong 2012. In addition, some of the decline was due to a reduction in wholesale inventories late in the year, some of which was reversed in 2014.

In 2015, cigarette shipment declines stopped, and manufacturers reported increased shipments for most of the year, with NAAG in April 2016 reporting shipments in 2015 up 1.9% over 2014.

Factors Affecting Cigarette Consumption

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

cigarettes, all of these factors are thought to affect smoking in some manner and to be incorporated into current levels of consumption. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by IHS Global, the awareness of the population continues to change in this way, overall consumption of cigarettes will decline gradually over time. IHS Global's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables, which are difficult to quantify.

Comparison with Prior IHS Global Consumption Forecast

In January 2006 IHS Global, then Global Insight, presented a similar study, "*A Forecast of U.S. Cigarette Consumption (2004-2043) for TSASC, Inc.*" That report, in its base case forecast, projected consumption in 2042 of 199 billion cigarettes, reflecting an average decline rate of 1.8%. A sharp acceleration in the decline rate resulted in a substantial forecast error. The current forecast projects an average decline rate of 3.0% through 2052, to an annual consumption level of 88.2 billion cigarettes (or 88.8 billion including roll-your-own (or "**RYO"**) tobacco equivalents). The new forecast was developed with consideration of the large federal tax increase in 2009 and of the negative effects of the proliferation of smoking ban legislation across the United States, among other factors.

IHS GLOBAL TRIBAL SALES REPORT

The following is a brief summary of the IHS Global Tribal Sales Report, a copy of which is attached hereto as APPENDIX A-2. This summary does not purport to be complete and the IHS Global Tribal Sales Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. IHS Global's forecasts are estimates which have been prepared by IHS Global on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of and no representation or warranty should be inferred from, these forecasts. The forecast contained in the IHS Global Tribal Sales Report is based upon assumptions as to future events and, accordingly, is subject to varying degrees of uncertainty. Some assumptions inevitably will not materialize and, additionally, unanticipated events and circumstances may occur. Therefore, for example, actual tribal sales inevitably will vary from the forecast included in the IHS Global Tribal Sales Report and the variations may be material and adverse. No assurance can be given that tribal sales during the term of the Series 2017 Bonds will be as assumed. See "RISK FACTORS" herein.

General

IHS Global has prepared a report dated November 7, 2016 projecting the amount of tribal NPM cigarettes purchased by New York non-tribal consumers from retailers located on Native American reservations and lands in the State from 2015 through 2052, entitled "Cigarette Purchases by New York Consumers from Tribal Retailers in New York State" (the "**IHS Global Tribal Sales Report**"), which was submitted to TSASC.

IHS Global has developed a cigarette sales model which estimates and projects the sales of tribal cigarettes at tribal shops in New York. This model, coupled with IHS Global's long-term forecast of the United States cigarette consumption and IHS Global's demographic forecast of the State's counties, have been used to project tribal cigarette sales in the State from 2015 through 2052. IHS Global estimates that a total of 54.2 million packs were sold by reservation retailers to non-tribal New York consumers in 2015, and forecasts that tribal cigarette sales to New York non-tribal consumers will fall by 75% to 13.5 million packs by 2052. IHS Global also presents two alternative scenarios—one high and one low—for tribal cigarette sales; in these scenarios, IHS Global varies the impact on demand for tribal brand cigarettes based on the price differential received by consumers.

Tax-Free Tribal NPM Cigarette Sales at New York Tribal Stores

There are nine Native American tribes or nations ("**tribes**") in New York State that are recognized by either the federal or State government, with a total of eleven recognized Native American reservations or other tribal land areas ("**reservations**") from which the tribes or their members sell tax-free tribal NPM cigarettes to non-tribal consumers. The locations of such tribes and reservations are described in the IHS Global Tribal Sales Report.

Tribal shops sell tax-free tribal NPM cigarette brands for approximately $2 to $4 per pack, considerably less than the approximately $9.00 average price, including all State and local taxes, observed at New York convenience stores for discount brands of PMs under the MSA. According to IHS, prices appear to be lowest on reservations with numerous outlets selling tribal cigarettes.

Cigarette Consumption and Sales in New York State

The portion of the population in the State that smokes has declined over the last few decades along with the rest of the country. Meanwhile, the State's taxable cigarette sales have been declining at a faster rate, from over 55 packs per year per capita in 2000 to less than 17 packs per year per capita this decade. Since 2000, per capita U.S. cigarette sales have fallen by 48% as smoking prevalence has fallen by 28%. At the same time, while New York smoking prevalence, always less than that of the nation, has declined by a similar amount, 26%, taxable sales have fallen by a far larger amount, 73%. IHS Global's conclusion, also supported by other research, is that a large share of cigarette use in the State is with cigarettes which evade the State's highest-in-the-nation state cigarette tax.

The State's smokers have many ways to avoid paying the State's high cigarette taxes by purchasing cigarettes from sources that have not paid the State's tax and, where applicable, New York City's added tax. IHS Global notes that State smokers may access the premium and discount cigarettes produced by the PMs from stores and retail outlets located in low-tax states, duty free shops in airports or along the Canadian border, and, reportedly, from the many retail stores and street vendors in New York City who sell illegal smuggled cigarettes. The State's consumers also can drive to a store on any one of the Native American reservations or other tribal lands in the State to purchase lower cost (and in most cases tax-free cigarettes) manufactured by NPMs located on Native American reservations in the State and elsewhere. A 2015 study by the Mackinac Center for Public Policy and the Tax Foundation concluded that New York State has the highest inbound smuggling rate nationwide (with inbound smuggling in this case including the cigarettes sold tax-free on the reservations), with illegally imported or untaxed tribal cigarettes making up 58% of the State's total market in 2013.

IHS Global has performed calculations starting with U.S. consumption of 269 billion cigarettes in 2015, taking the State's share of the adult population, deflating by the relative smoking prevalence difference as measured by the CDC between the State and the U.S., to conclude that New York smokers likely consumed 761 million packs in 2015. With State tax revenues indicating taxable sales of 289 million packs (as reported by the New York State Department of Tax and Finance), this is a shortfall of 62%.

Estimating Tribal Cigarette Sales to New York Consumers

IHS Global employs a "bottom-up" approach to estimate tribal cigarette sales to non-tribal New York consumers based on their proximity to a Native American reservation. The IHS Global Tribal Sales Report states that the incidence of cigarette purchases by New York consumers from tribal stores depends on three key factors—the consumers' willingness and ability to travel to a reservation, the potential discount received by purchasing cigarettes from tribal stores, and consumers' brand loyalty and demand elasticity for cigarettes.

IHS Global uses in its calculations its own forecast of county-level population across the State, as well as its projection of total cigarette sales for the United States. IHS Global notes that an important and implicit assumption in its projection is that the share of cross-border cigarette sales remains constant over the forecast period. To calculate its forecast, IHS Global estimates the total taxed and untaxed consumption of cigarettes in each county in the State multiplied by a factor (which varies from county to county based on proximity to tribal shops), expressed as a percentage, of the propensity of smokers in each county to purchase a tribal brand at a tribal shop.

THE TRUST AND THE RESIDUAL CERTIFICATE

The Trust has been organized as a Delaware statutory trust. The Residual Certificate was transferred by TSASC to the Trust, and the beneficial ownership of the Trust was transferred by TSASC to the City as part of the purchase price of the Tobacco Assets.

The Residual Certificate represents the entitlement to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate. Payments on the Residual Certificate from Collections are subordinate to payments on the Bonds.

CONTINUING DISCLOSURE UNDERTAKING

In order to assist the Underwriters in complying with the provisions of paragraph (b)(5) of Rule 15c2-12 (the "**Rule**"), promulgated by the Securities and Exchange Commission (the "**SEC**") under the Securities Exchange Act of 1934, as amended (the "**1934 Act**"), for the benefit of the holders and beneficial owners of the Series 2017 Bonds, TSASC will enter into a Continuing Disclosure Undertaking, dated the Closing Date (the "**Continuing Disclosure Undertaking**"), pursuant to which TSASC will provide or cause to be provided to the Municipal Securities Rulemaking Board, on its Electronic Municipal Market Access ("**EMMA**") system, certain annual financial information and operating data and notice of the occurrence of certain enumerated events. Specific performance is the only available remedy under the Continuing Disclosure Undertaking.

The form of the Continuing Disclosure Undertaking is attached as APPENDIX H.

On January 26, 2015, S&P made a rating change to the 2022 and 2026 maturities of TSASC's Tobacco Settlement Asset-Backed Bonds, Series 2006-1; however, TSASC's notice of these rating changes was not posted on EMMA until July 30, 2015. In addition, a certain mandatory turbo redemption of the Tobacco Settlement Asset-Backed Bonds, Series 2006-1 (2022 maturity) occurred on June 1, 2013; however, notice of such redemption was not posted on EMMA until May 28, 2014. Furthermore, a certain mandatory turbo redemption of the Tobacco Settlement Asset-Backed Bonds, Series 2006-1 (2022 maturity) occurred on December 1, 2013; however, notice of such redemption was not posted on EMMA until May 28, 2014.

TAX MATTERS

Federal Income Taxes

In the opinion of Orrick, Herrington & Sutcliffe LLP ("**Transaction Counsel**"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, the interest on the Series 2017 Bonds is: (i) excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "**Code**"), and (ii) not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Transaction Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Transaction Counsel expresses no opinion regarding any other federal tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds. A complete copy of the proposed form of opinion of Transaction Counsel is set forth in APPENDIX G hereto.

To the extent the issue price of any maturity of the Series 2017 Bonds is less than the amount to be paid at maturity of such Series 2017 Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 2017 Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each beneficial owner thereof, is treated as interest on the Series 2017 Bonds which is excluded from gross income for federal income tax purposes. For this purpose, the issue price of a particular maturity of the Series 2017 Bonds is the first price at which a substantial amount of such maturity of the Series 2017 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series 2017 Bonds accrues daily over the term to maturity of such Series 2017 Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series 2017 Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Series 2017 Bonds. Beneficial owners of the Series 2017 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series 2017 Bonds with original issue discount, including the treatment of beneficial owners who do not purchase such Series 2017 Bonds in the original offering to the public at the first price at which a substantial amount of such Series 2017 Bonds is sold to the public.

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

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series 2017 Bonds. These include, among other things, certain restrictions and prohibitions on the use of the proceeds of the Series 2017 Bonds and the facilities and improvements financed with such proceeds, restrictions on the investment of bond proceeds and other amounts and the payment of rebate to the United States Treasury of certain earnings in respect of such investments. TSASC and the City have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series 2017 Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Series 2017 Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Series 2017 Bonds. The opinion of Transaction Counsel assumes the accuracy of these representations and compliance with these covenants. Transaction Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Transaction Counsel's attention after the date of issuance of the Series 2017 Bonds may adversely affect the value of, or the tax status of interest on, the Series 2017 Bonds. Accordingly, the opinion of Transaction Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

State Income Taxes

In the opinion of Transaction Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants the interest on the Series 2017 Bonds is excluded from adjusted gross income for purposes of personal income taxes imposed by the State of New York and The City of New York to the extent that such interest is excluded from gross income for federal income tax purposes.

Interest on the Series 2017 Bonds may or may not be subject to state or local income tax laws in jurisdictions other than the State of New York under applicable state or local tax laws. Transaction Counsel expresses no opinion regarding any other state tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 2017 Bonds.

Other Considerations

Although Transaction Counsel is of the opinion that interest on the Series 2017 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code and excluded from adjusted gross income for purposes of personal income taxes imposed by the State of New York and The City of New York, to the extent that such interest is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of amounts treated as interest on, the Series 2017 Bonds may otherwise affect a beneficial owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the beneficial owner or the beneficial owner's other items of income or deduction. Transaction Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Series 2017 Bonds to be subject, directly or indirectly, in whole or in part, to federal income taxation or to be subject to state income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. For example, the Obama Administration's budget proposals in recent years have proposed legislation that would limit the exclusion from gross income of interest on the Series 2017 Bonds to some extent for high-income individuals. The introduction or enactment of any such legislative proposals or clarification of the Code or court decisions may also affect, perhaps significantly, the market price for,

or marketability of, the Series 2017 Bonds. Prospective purchasers of the Series 2017 Bonds should consult their own tax advisors regarding the potential impact of any pending or proposed federal or state tax legislation, regulations or litigation, as to which Transaction Counsel is expected to express no opinion.

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

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

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

ALL PROSPECTIVE PURCHASERS OF THE SERIES 2017 BONDS SHOULD CONSULT WITH THEIR ADVISORS IN ORDER TO UNDERSTAND THE IMPLICATIONS OF THE CODE AND TREASURY REGULATIONS AS TO THESE AND OTHER FEDERAL TAX CONSEQUENCES AS WELL AS ANY LOCAL TAX CONSEQUENCES OF PURCHASING AND HOLDING THE SERIES 2017 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 2017 Bonds or questioning the creation, organization or existence of TSASC, the validity or enforceability of the Indenture, the sale of the Tobacco Assets by the City to TSASC, the proceedings for the authorization, execution, authentication and delivery of the Series 2017 Bonds or the validity of the Series 2017 Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "RISK FACTORS", "LEGAL CONSIDERATIONS" and "CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY."

RATINGS

It is expected that, upon issuance of the Series 2017 Bonds, S&P Global Ratings (together with its predecessor organizations, "**S&P**" or the "**Rating Agency**") will assign a rating of "A" for the Series 2017A Senior Bonds maturing June 1, 2017* through June 1, 2026*; a rating of "A-" for the Series 2017A Senior Bonds maturing June 1, 2027* through June 1, 2036*; a rating of "BBB+" for the Series 2017A Senior Bonds maturing June 1, 2041*; and a rating of "BBB" for the Series 2017B Subordinate Bonds maturing June 1, 2042* and June 1, 2045*. S&P has not assigned a rating to the Series 2017B Subordinate Bonds maturing June 1, 2052*.

According to the S&P ratings guide, (a) the "sf" identifier shall be assigned to ratings on "structured finance instruments" when required to comply with applicable law or regulatory requirement or when S&P believes

* Preliminary, subject to change.

it appropriate, and (b) the addition of the "sf" identifier to a rating does not change that rating's definition or S&P's opinion about the issue's creditworthiness.

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

There is no assurance that the initial ratings assigned to the rated Series 2017 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by the Rating Agency. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the availability of a market for or the market price of such rated Series 2017 Bonds.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2017 Bonds, the arithmetical accuracy of certain computations included in schedules provided by the Underwriters on behalf of TSASC relating to (i) the adequacy of forecasted receipts of principal of and interest on the U.S. Treasury securities and cash to be held pursuant to the Refunding Escrow Agreement; (ii) the forecasted payments of principal and interest with respect to the Refunded Bonds on and prior to their redemption date; (iii) the yields with respect to the Series 2017 Bonds and on the securities to be deposited pursuant to the Refunding Escrow Agreement for the purposes described in (i) above, and (iv) certain other matters identified by Transaction Counsel, will be verified by Grant Thornton LLP, independent certified public accountants (the "**Verification Agent**"). Such verification shall be based solely upon information and assumptions supplied to the Verification Agent by the Underwriters. The Verification Agent has not made a study or evaluation of the information and assumptions on which such computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions or the achievability of the forecasted outcome.

UNDERWRITING

The Series 2017 Bonds are being purchased by the underwriters listed on the cover page hereof (the "**Underwriters**"), for whom Jefferies LLC is acting as lead manager.

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2017 Bonds from TSASC at an aggregate underwriters' discount of $_____, which underwriters' discount includes reimbursement for expenses of counsel and other expenses.

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

In addition, certain of the Underwriters have entered into distribution agreements with other broker-dealers (that have not been designated by TSASC as Underwriters) for the distribution of the Series 2017 Bonds at the original issue prices. Such agreements generally provide that the relevant Underwriter will share a portion of its underwriting compensation or selling concession with such broker-dealers.

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

In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative

securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve securities and instruments of TSASC.

LEGAL MATTERS

Orrick, Herrington & Sutcliffe, LLP, New York, New York, as Transaction Counsel, will render an opinion with respect to the validity of the Series 2017 Bonds in substantially the form set forth in APPENDIX G—"PROPOSED FORM OF OPINION OF TRANSACTION COUNSEL" hereto. Certain legal matters with respect to TSASC will be passed upon by Orrick, Herrington & Sutcliffe, LLP, as Transaction Counsel. Certain legal matters with respect to the City will be passed upon by its Corporation Counsel. Certain legal matters will be passed upon for the Underwriters by Hawkins Delafield & Wood LLP, New York, New York, and Hardwick Law Firm LLC, New York, New York, as Co-Underwriters' Counsel.

OTHER PARTIES

Financial Advisors

Acacia Financial Group, Inc., New York, New York, and Public Financial Management, Inc., New York, New York, are acting as financial advisors to TSASC in connection with the issuance of the Series 2017 Bonds.

IHS Global

IHS Global has been retained by TSASC as an independent econometric consultant. The IHS Global Consumption Report attached as APPENDIX A-1 and the IHS Global Tribal Sales Report attached as APPENDIX A-2 are included herein in reliance on IHS Global as experts in such matters. IHS Global's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2017 Bonds. The IHS Global Consumption Report and the IHS Global Tribal Sales Report should each be read in its entirety.

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APPENDIX A

IHS GLOBAL REPORTS

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APPENDIX A-1

IHS GLOBAL CONSUMPTION REPORT

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A Forecast of U.S. Cigarette Consumption (2016-2052) for TSASC, Inc.

Submitted to:

TSASC, Inc.

Prepared by:

IHS Global Inc.

November 7, 2016

James Diffley
Senior Director

IHS Global Inc.
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Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2015. 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 2016 through 2052. Our forecast indicates that total consumption in 2052 will be 88.20 billion cigarettes (or 88.8 billion including roll-your-own ("RYO") tobacco equivalents), a 67% decline from the 2015 level. From 2015 through 2052 the average annual rate of decline is projected to be approximately 3.0%.

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

Disclaimer

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

Cigarette Use in the United States

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[1]. Prior to 1900, tobacco was most frequently used in pipes, cigars, and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable U.S. consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico, and other U.S. possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The USDA, which compiled data on cigarette consumption between 1900 and 2007, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981[3]. Consumption declined in the 1980s, 1990s, and 2000s, reaching a level of 465 billion cigarettes in 1998 and decreased to less than 400 billion cigarettes in 2003[4] and under 300 billion in 2011[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

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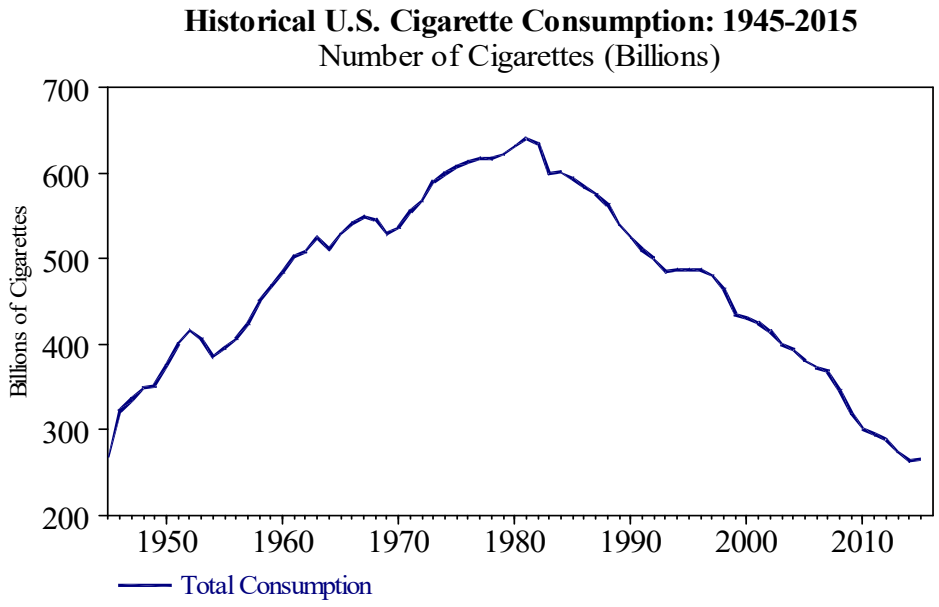
[1] *Source*: "Tobacco Timeline," Gene Borio (1998).
[2] Bureau of Alcohol, Tobacco, Firearms, and Explosives reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.
[3] *Source*: "Tobacco Situation and Outlook", U.S. Department of Agriculture-Economic Research Service, September 1999 (USDA-ERS).
[4] *Source*: USDA-ERS. April 2005.
[5] *Source*: US Tobacco and Tax Bureau, MSAI



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

The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline in the number of cigarettes (including ryo equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette) for that year, 9.1% in 2009, and 6.4% in 2010.

There was a confluence of factors which led to the dramatically reduced consumption in 2009. First, indoor smoking bans spread rapidly across the country in the latter half of the decade. We now estimate that their impact on decreased smoking and cigarette consumption was approximately 6 billion cigarettes in 2009. Second, the latter months of

2008 saw a very deep recession. Our model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion cigarettes. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009 decreased cigarette demand by about 10 billion in 2009 according to our model of price elasticity. Fourth, the acceleration, prompted by the recession, of state excise tax increases similarly reduced consumption by a further 4 billion.

The consumption decline finally decelerated to 2.8% in 2011 and 2.0% in 2012. In 2013 the decline sharpened to nearly 5%. This decline has been attributed by the industry to a weak economy, the rapid increase in usage of electronic -cigarettes ("e-cigarettes"), and to an unfavorable comparison with a surprisingly strong 2012. In addition, some of the decline was due to a reduction in wholesale inventories late in the year, part of which was reversed in 2014.

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

In 2015 cigarette shipment declines stopped, and indeed manufacturers reported increased shipments for most of the year. Through December, the Alcohol and Tobacco Tax and Trade Bureau ("TTB") reported that shipments of 267.0 billion cigarettes exceeded the 2014 level by 1.7%. Altria, in its full year 2015 financial report, estimated that industry shipments for 2015 were 0.5% below that in 2014. RAI, in its 2015 earnings release, indicated that MSAI estimates total industry shipments at 264.3 billion cigarettes, a 0.1% increase from 2014. On April 21, 2016 NAAG released its 2015 data, reporting shipments of 270.8 billion cigarettes (including ryo equivalents), a 1.9% increase from 2014.

The following table sets forth United States domestic cigarette consumption, with and without roll-your-own equivalents, for the eighteen years ended December 31, 20156. The data in this table vary from statistics on cigarette shipments in the United States. While this Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of

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

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	Consumption (Billions of Cigarettes with roll-your-own equivalents)	Percentage Change
2015	269	1.94	271	1.87
2014	264	-3.77	266	-3.84
2013	274	-4.82	276	-4.73
2012	288	-1.85	290	-1.97
2011	294	-2.58	296	-2.77
2010	301	-5.52	305	-6.36
2009	319	-8.03	325	-9.09
2008	348	-4.35	358	-3.79
2007	368	-2.28	372	-4.97
2006	377	-1.93	391	0.26
2005	384	-2.69	390	-3.51
2004	395	-1.28	404	0.09
2003	400	-3.66	404	-3.30
2002	415	-2.35	418	-2.68
2001	425	-1.16	429	-1.51
2000	430	-1.15	436	-1.30
1999	435	-6.45	442	
1998	465	-3.13		

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to MSAI, the two leading manufacturers, Altria and Reynolds American, accounted for 76.5% of U.S. shipments in 2015. In 2014, prior to the purchase of Lorillard by Reynolds American, the three manufacturers accounted, according to the NAAG, for 84.7% of U.S. shipments in 2014, down from 84.9% in 2013, but up from 84.5% in 2012 and 2011, and 83.6% in 2010. (The acquisition of Lorillard coincided with a sale of certain Lorillard and Reynolds brands to Imperial Tobacco.) On October 21, 2016, British American Tobacco announced an offer to takeover Reynolds American.

In April 2016 NAAG determined that total shipments by the remaining Original Participating Manufacturers ("OPMs"), Altria and Reynolds American, which is the basis for the computation of 2015 MSA payments, in 2015 equaled 226.2 billion, a 0.1% decline from 2014, which resulted in a decline in the OPMs market share to 83.6%. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the MSA and other state settlement agreements.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue had fallen from 3.4% in 1950 to approximately 0.4% prior to the 2009 federal excise tax increase. In fiscal year 2015, the federal government received $14.5 billion in excise tax revenue from tobacco sales. In addition, state governments also raised significant revenues, $17.8 billion in 2015 from excise taxes. Cigarettes constitute the majority of these sales, which also include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

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

Incidence of Smoking

Approximately 40 million American adults were current smokers in 2015, representing approximately 15.1% of the population age 18 and older, a decline from 16.8% in 2014, from 17.8% in 2013, and from 19.4% in 2010, according to a Centers for Disease Control and Prevention ("CDC") study released in 2016. This survey, the National Health Interview Survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the

survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in 1965 to 25.5% in 1990 and 24.1% in 1998, the incidence rate has declined relatively slowly since 1998. The decline had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when the incidence rate dropped to 20.9%, though it remained as high as 20.6% in 2009. The 2014 CDC report also indicated that the percentage of smokers who smoked less than 30 cigarettes per day had declined from 12.6% to 7.0% since 2005.

The CDC, in September 2011, released the results of a study of quitting smoking[7]. It found that, in 2010, 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit. In January 2014 the CDC released further results indicating the quit rates had increased to 52.9% for attempts made in the past year.

A recent trend, likely influenced by extensive indoor smoking bans in the U.S., is growing numbers of "light smokers", those who smoke just a few cigarettes per day. Thus the decline in the overall prevalence of smoking has slowed while the rate of decline of the volume of cigarettes consumed has accelerated. In a similar fashion e-cigarettes have replaced cigarette consumption in locations subject to indoor smoking bans, to the extent that e-cigarettes are not similarly excluded. (see p 12 below)

Youth Smoking

Certain studies have focused in whole or in part on youth cigarette consumption. Surveys of youth typically define a "current smoker" as a person who has smoked a cigarette on one or more of the 30 days preceding the survey. The CDC's Youth Risk Behavior Surveillance System ("YRBSS") estimated that from 1991 to 1999 incidence among high school students (grades 9 through 12) rose from 27.5% to 34.8%, representing an increase of 26.5%. By 2003, incidence had fallen to 21.9%, a decline of 37.1% over four years. The rate of decline has continued, though at a slower pace. By 2011, the prevalence was 18.1%.[8] It declined to 15.7% in the 2013 survey and to 10.8% in 2015.

According to the Monitoring the Future Study, a school-based study of cigarette consumption and drug use conducted by the Institute for Social Research at the University of Michigan, smoking incidence over the prior 30 days among eighth, tenth, and twelfth graders was, for the second consecutive year, lower in 2015 than in 2014, continuing trends that began in 1996. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

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

Grade	1991 (%)	2013 (%)	2014 (%)	2015 (%)	'91-'15 Change (%)
8th	14.3	4.5	4.0	3.6	-74.8%
10th	20.8	9.1	7.2	6.3	-69.7%
12th	28.3	16.3	13.6	11.4	-59.7%

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

The 2013 National Survey on Drug Use and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services ("SAMHSA") estimated that approximately 55.8 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). The survey found that an estimated 5.6% of youths age 12 to 17 were current cigarette smokers in 2013, down from 8.4% in 2010 and 13.0% in 2002. SAMHSA released its 2015 survey on September 8, 2016. It indicated that the percentage of youths age 12 to 17 who were current smokers in 2015 declined to 4.2%.

The CDC reported on April 14, 2016 that the National Youth Tobacco Survey found that in 2015 the prevalence of tobacco product use among middle and high school students was 7.4% and 25.3%, respectively. For cigarettes the prevalence was 2.3% and 9.3%, respectively. While cigarette use is substantially lower than the Survey indicated in 2011, overall tobacco use is higher as 16% of high school students and 5.3% of middle school students reported using e-cigarettes in the past 30 days.

In most of the nation the minimum legal age to purchase cigarettes is 18. In 2013 New York City increased that age to 21, in 2014 Suffolk County, NY did so, and in February 2015 Cambridge and Framingham, MA did so as well, followed by Boston, Chicago, Cleveland, Kansas City, and San Francisco in 2016. The Campaign for Tobacco-Free Kids reports that at least 180 localities in 14 states have raised the minimum legal age to 21. Hawaii became the first state to raise its legal age to 21 on January 1, 2016, and California legislation to do the same went into effect June 9, 2016. A similar proposal to raise the smoking age to 21 has also been introduced in the Colorado, Massachusetts, Missouri, New Jersey, New York State, Ohio, Pennsylvania, Rhode Island, Utah, Vermont, and Washington legislatures, and in the Council of the District of Columbia

Four states Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19.

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

Price Elasticity of Cigarette Demand

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

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[9] 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.[10] 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.[11] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost the entire 12% drop in youth smoking over that time.

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[9] *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.

[10] 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.

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

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[12]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[13] 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.[14]

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

The CDC reports that, in a 2013 survey, two-thirds of all smokers reported some quit attempt in the past year. Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. Many researchers now recommend that those trying to quit smoking use a variety of these methods in combination.

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[12] 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.

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

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

One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[15] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In 2002, the Food and Drug Administration ("FDA") approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another cessation product on the market since 2003. Beginning October 2015, it has been available for purchase without a prescription, and a wholesale distribution marketing campaign is underway. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[16]

In 2006, the FDA approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact. The drug debuted with strong sales in 2007, but suffered a reversal the following year due to safety concerns. It has since seen increased sales and marketing success. Free & Clear, a provider of tobacco treatment services, reported in June 2008, that Chantix has achieved higher average quit rates than Zyban, patches, gum, and lozenges. Though Pfizer reported additional positive results in 2009, the FDA required that Pfizer update the Chantix label with the most restrictive, "Black Box", safety labeling describing the risks. But the FDA does conclude: "The Agency continues to believe that the drug's benefits outweigh the risks and the current warnings in the Chantix label are appropriate." These warnings include changes in behavior, hostility, agitation, depressed mood, and suicidal thoughts or actions, as well as serious skin reactions and heart and blood vessel problems. Nevertheless the FDA said on October 24, 2011 that it will continue to evaluate the risk of mood changes and other psychiatric events associated with its use. In March 2013, researchers at the University of Texas M.D. Anderson Cancer Center reported a better quitting experience with varenicline than other treatments. In September 2013 researchers in a Pfizer sponsored study concluded that the drug does help some patients with depression or mood disorders to quit smoking without worsening symptoms of depression or anxiety, though in September 2016 a preliminary review by the FDA expressed doubts about the trial. Although an advisory agency has voted the remove the Black Box labeling, the FDA has yet to do so. Also, in October 2013 researchers at the University of Bristol reported in the British Medical Journal that cessation drugs do not increase suicide risk. This was followed by a 2015 study in Sweden which reached the same conclusion. In January 2016 a study concluded that the relative effectiveness of Chantix was equal to that of nicotine patches.

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

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

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

In 2011, the FDA cleared an Investigational New Drug Application to conduct a Phase II-B trial of X-22, a smoking cessation kit of very low nicotine cigarettes made by the 22nd Century Group. The company has continued its development plans, and in 2016 the New Zealand Medical Journal recommend the low-nicotine cigarettes as a smoking reduction tool.

In 2012, a team from Weill Cornell Medical College reported the development of an anti-nicotine vaccine using a genetically engineered virus. The vaccine was successful in test with mice, though it will take several years before it can be tested in humans. More recently, in January 2015 a team from the Scripps Research Institute reported in the Journal of Medicinal Chemistry that a new vaccine design had yielded positive results and recommended its further development. In October 2015, Invion Limited completed a successful Phase 2 trial of INV102 (Nadolol), an inhaled respiratory drug for smoking cessation. The company has requested that the FDA move this drug to Phase 3 development.

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

It is expected that products such as these and others will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Further aiding sales of these products is the decision by 45 state Medicaid programs to offer cessation benefits to Medicaid beneficiaries. And at least ten states (California, Colorado, Maryland, New Jersey, New Mexico, New York, North Dakota, Oregon, Rhode Island, and Vermont) have established minimum standards for private insurance coverage of cessation products and services. In October 2010, Medicare coverage was expanded to provide cessation counseling to seniors without tobacco-related disease. The Affordable Care Act now mandates that new private health insurance plans cover tobacco cessation, and effective January 2014, that tobacco cessation medications can no longer be excluded from state Medicaid coverage.

Electronic Cigarettes

E-cigarettes, which according to the OPMs are not subject to the MSA, have also gained in popularity in recent years. NJOY, Vapor, Logic, and Blu, are marketed and advertised extensively across the US. Sales in 2015 have been estimated to be over $4 billion, having increased rapidly. The CDC in September 2014 reported survey results that indicate 8.5% of the adult population, and 36.5% of smokers, had tried e-cigarettes at

some time. These were almost quadruple estimates in 2010. In June 2016, the CDC released YRBSS survey results indicating that 45% of high school students had tried e-cigarettes in 2015, compared to only 32% who had tried cigarettes. In April 2016, its National Youth Tobacco Survey found that e-cigarette use among high school students had increased to 16% in 2015, from 1.5% in 2011. It was 5.3% among middle school students in 2015.

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

The American Legacy Foundation conducted a 2013 survey which found, among the 41% of smokers who intended to quit smoking in 2014, 12% planned to switch to e-cigarettes. In October 2015 National Center for Health Statistics of the CDC reported that in 2014 12.6% of adults had tried e-cigarettes, and 3.7% of adults were current users. In November 2015, the Rutgers School of Public Health released a study showing that in 2014, e-cig users included 49% of current smokers. And recent quitters were more likely to be daily e-cigarette users (13.5%), than current smokers (3.5%). This may indicate that regular e-cig use may help smokers quit smoking. Also in October 2015, a Yale University study found that states which have banned e-cigarettes and vaporizers to those under 18 have experienced an increase in smoking. The authors concluded that e-cigarette access reduces teen smoking.

In October 2013, a study at the University of Oklahoma Health Science Center concluded that e-cigarettes do not appear to entice teens to try smoking tobacco. In 2014, University College of London researchers indicated finding that e-cigarettes were 60% more effective than over-the-counter nicotine replacement therapies in smoking cessation attempts. In August 2014, Kantar Media reported survey results indicating that almost 6 million adults in the US use e-cigarettes, and that of the adults who used a cessation product in the past year, 57% chose e-cigarettes. A study of college students published in the December 2014 American Journal of Preventative Medicine concluded that its results

refuted the claim that e-cigarettes are a gateway to smoking. Also, subsequent research in December 2015 revealed that 60 percent of student users vape nicotine-free liquids.

For the consumer, e-cigarettes are a less expensive alternative as they are not taxed as cigarettes. (Minnesota has imposed a 95% tax on the wholesale cost however, North Carolina in 2014 added a 5 cent per milliliter tax on liquid nicotine, and the District of Columbia, Kansas, and Louisiana added millimeter taxes in 2015. Though smoking habits vary, a 5 cent/mL tax is approximately equivalent to a 2.5 cent tax per pack of cigarettes. A cartridge and battery for an e-cigarette would cost less than half as much as an equivalent pack of cigarettes in an average tax state.

Researchers have reported several safety concerns with the products, including concerns on the variability in delivered nicotine content. In March 2016 the U.S. Department of Transportation implemented a ban on e-cigarettes on all flights to and from the U.S., a prohibition already enacted by Amtrak on its trains. The states of California, Connecticut, Hawaii, Maine, New Jersey, North Dakota, Oregon, and Utah prohibit e-cigarette use in workplaces, restaurants, and bars. Arkansas, Colorado, Delaware, New Hampshire, and Oklahoma restrict e-cig use at state workplaces and school grounds. And there are, based on data from the American Nonsmokers' Rights Foundation ("ANRF"), e-cigarette restrictions at indoor smoke-free venues in 516 localities in the US. In 2014, Chicago, New York, and San Francisco have extended public places smoking bans to include e-cigarettes. In September 2013 forty state attorneys general sent a letter to the Food and Drug Administration (FDA) urging the agency to regulate e-cigarettes in the same way it regulates tobacco products. In 2014 the state of Rhode Island banned e-cig sales to those under 18 years of age.

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

In August 2013, the Consumer Advocates for Smoke-free Alternatives Association released a study it funded by the Drexel University School of Public Health. It found that chemicals in e-cigarettes pose no health concern for users or bystanders. In August 2014,

the American Health Association backed the use of e-cigarettes as a last resort (after other cessation methods) to help smokers quit.

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.[17] Their results suggest that workplace smoking bans reduce smoking prevalence by five percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day a smoker spent working in a smoking restricted environment, the greater the decline in the quantity of cigarettes that smoker consumed.

Factors Affecting Cigarette Consumption

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

Price Elasticity of Demand. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using U.S. data from 1965 to 2015, the long-run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

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

[17] *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.

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

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

In 2013, Cook County, Illinois increased its cigarette excise tax by $1.00 per pack, and in November of that year Chicago increased its excise tax by $0.50 to push city, county, and state taxes in Chicago to $7.17 per pack. Also in 2013, cigarette excise tax increases were enacted in Minnesota, by $1.60 per pack, Massachusetts, by $1.00 per pack, Oregon, by $0.13 per pack, and in New Hampshire, by $0.10 per pack. Puerto Rico also enacted plans to increase its excise taxes in 2014 and 2015. In November 2013, New York City passed an ordinance that set a minimum retail price of a pack of cigarettes at $10.50, and prohibited the use of coupons and promotions to discount that price. In September 2014, the City of Philadelphia enacted a $2.00 per pack tax.

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

In 2016, the excise tax was increased in Minnesota, by $0.10, and Oregon, by $0.01,on January 1, in Louisiana, by $0.22 on April 1, and in Connecticut, by $0.25 and in West Virginia, by $0.65, on July 1. The Pennsylvania budget enacted on July 14 increased its excise tax by $1.00 per pack effective August 1. Excise tax increases are under consideration in Illinois, New Mexico, and Wyoming. Ballot initiatives for excise tax increases are in place for November 2016 in California ($2.00), Colorado ($1.75), Connecticut ($1.75), Missouri ($0.13), and North Dakota ($1.76). The average state excise tax is now $1.63.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009 when the U.S. Congress adopted legislation which raised the tax by $0.62, to $1.01, effective April 1, 2009. As a result the total state and federal excise tax now equals $2.54 on average in the U.S. In 2011 a U.S. senate bill was sponsored by 14 Democrats and would have raised the excise tax to $2.01 per pack, but it was not successful. On January 22, 2013, Senator Tom Harkin introduced legislation, the Healthy Lifestyles and Prevention America Act, which would double the Federal excise tax on cigarettes and roll-your-own tobacco and increase the tax on smokeless tobacco products. President Obama's 2017 federal budget proposal once again includes an increase in the Federal Excise Tax of $0.94, to $1.95 per pack, and indexes the rate to inflation.

Purchases of roll-your-own cigarette tobacco were discouraged by 2009 legislation, as its excise tax was raised substantially. But the excise tax changes also had the effect of encouraging the use of pipe tobacco, combined with the availability of roll-your-own machines to circumvent the higher excise taxes. Legislation introduced by Senator Richard Durbin on January 31, 2013, and most recently on February 11, 2015, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products.

During much of the period following the MSA, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which stabilized in 2004. The major manufacturers have raised prices or reduced discounts and promotions in each year since 2004. In 2014, for instance, Altria raised its brands prices increased by $0.13, and in May 2015, and again in May 2016, the major manufacturers increased prices by $0.06 per pack. The average price, including excise taxes in September 2016 was $7.94 per pack.
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Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes.

Premium brands are typically $1.00 to $2.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The availability of cigarette outlets on Indian reservations, where some sales are typically exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes initially grew rapidly, though credit card companies and shippers including the U.S. Postal Service have now put significant restrictions on shipping of cigarettes, and the federal government has enacted the Prevent All Cigarette Trafficking ("PACT") Act which requires the collection of all applicable taxes on Internet and mail-order cigarette shipments. Under the MSA volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume, but it may negatively impact MSA receipts if non-participating manufacturers gain sales.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[18] However, a few studies found cigarette consumption decreases as disposable income increases.[19]

[18] Ippolito, et al.; Fuji.
[19] Wasserman, et al.; Townsend et al.

Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%. In normal periods of economic growth this factor contributes a positive impact to cigarette demand, offsetting some of the negative impacts previously discussed. However, with the recession of 2008-2009 this factor also impacted cigarette demand and consumption in a negative way.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[20] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[21] One study examines the effects of youth smoking on future adult smoking.[22] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

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

In 2012, the Surgeon General issued a report, "Preventing Tobacco Use among Youth and Young Adults". Among its major conclusions were, 1) that prevention efforts must focus on both adolescents and young adults, 2) that advertising and promotional activities by tobacco companies have been shown to cause the onset and continuation of smoking among youth, 3) that after years of steady progress, declines in tobacco use by the young have slowed, and 4) that coordinated, multi-component interventions that combine mass media campaigns, price increases, school-based programs, and community wide smoke-free policies and norms are effective in reducing tobacco use. Also in 2012 the CDC produced a mass-media advertising campaign featuring graphic descriptions of the adverse health effects of smoking. In August 2012, the CDC declared the campaign a major success, as the agency concluded that the ads helped to double the amount of calls to their telephone quit line. New CDC campaigns, with graphic adverse health images began in March 2013, and again in July 2014. In September 2013, the CDC announced survey results which concluded that cessation attempts increased from 31.1% to 34.8% of smokers who had seen the graphic ads, which the CDC extrapolated to 100,000 sustained quitters, approximately 0.25% of US smokers. In 2001, Canada had required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Early research suggested that these warnings have some effectiveness, as one-fifth of the

[20] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[21] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[22] *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.
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participants in a survey reported smoking less as a result of the labels.[23] In November 2013, the journal Tobacco Control published research from the University of Illinois at Chicago which concluded that the FDA has underestimated the impact of graphic labels. Examining the experience in Canada the researchers concluded that graphic warning labels reduced smoking rates in Canada by from 3 to 5 percentage points.[24]. In 2015 the Rand Corporation reported results of a convenience store experiment where cigarette displays were hidden from view. The researchers found that teen smoking susceptibility was reduced by 11% by the hidden placement.

In December 2014, research was published on the effectiveness of youth-targeted antismoking public service announcements. It was found that a 100-ad increase in the yearly volume of ads was associated with a 0.1 percentage point drop in youth smoking rates in the following year. And a 2016 study determined that smoke-free laws in workplaces are associated with a lower prevalence of youth smoking.[25] It estimated that youth smoking initiation declined by 34%.

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

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The Family Smoking Prevention and Tobacco Control Act requires that cigarette packages have larger and more visible graphic health warnings. Regulations that were to go into effect in September 2012 mandated that a series of nine graphic health

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

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

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

warnings must appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels. Five manufacturers challenged the implementation of these new warnings on First Amendment grounds, and on November 7, 2011 a federal judge issued a preliminary injunction blocking the FDA requirement. The judge ruled that the labels were not factual, but rather, "…calculated to provoke the viewer to quit…." In 2012, a federal judge in Washington blocked the new requirement, while an appeals court in Ohio ruled to uphold parts of the Act. In March 2013, the Attorney General decided not to ask the U.S. Supreme Court to review the case. Instead the FDA announced on March 19, 2013 that it would undertake research to support new rulemaking. On April 22, 2013, the Supreme Court upheld the provisions of the 2009 law, allowing the FDA to develop and implement new graphic warning labels.

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

At least six states, Alabama, Georgia, Idaho, Kentucky, South Carolina, and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and 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.

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

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

The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 39 states and a number of large cities. Restrictions to all workplaces, restaurants, and bars cover 65.4% of the U.S, according to the ANRF. In 2012 North Dakota became the most recent state to adopt these bans in public places. In 2015, smoking ban legislation has been introduced in Kentucky, and New Orleans has passed an ordinance banning smoking in bars and casinos.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of October 1, 2016, there were 4,579 municipalities with indoor smoking restrictions. Of these, 1,086 local governments required non-hospitality workplaces to be

100% smoke-free while 1,155 governments required 100% smoke-free conditions in restaurants, and 1,032 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars.[26]

Based on the regression analysis using data from 1965 to 2015, the restrictions on workplace smoking that proliferated in the 1980s appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970s have reduced smoking by about 2%. Nevertheless, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimates that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[27] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking, but have little influence on prevalence.[28] The study predicts that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking from 5% to 8%. In September 2015 the American Medical Association published research examining 11 years of smoke-free laws which concluded that they are associated with a lower prevalence of smoking among adolescents and young adults.[29]

The extension of the indoor bans to restaurants and bars in the last decade began largely in the Northeast and did not appear, in our econometric analysis, to have a significant independent impact on smoking there. Nevertheless, with data available from later in the decade across a wider geography, econometric analysis reveals that the bans did have a significant impact and we have added a variable quantifying the effect in our consumption model.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The cities of Los Angeles and Oakland, Contra Costa County, and the California municipalities of Belmont, Beverly Hills, Campbell, Concord, Dublin, El Cajon, Emeryville, Hayward, Loma Linda, Santa Cruz, San Rafael, Santa Monica, and Walnut Creek have also established extensive outdoor restrictions, as have Boulder, Colorado, and Davis County and the City of Murray in Utah. In 2007, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. In 2011, the New York City Council approved a bill to ban smoking in all city parks, beaches and pedestrian plazas. That ban went into effect on May 23, 2011. In

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[26] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. July 2013.

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

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

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

January 2014, a smoking ban went into effect in Boston's parks, and on Hawaii's beaches. A bill has been introduced in 2016 in California to ban smoking on all state beaches. According to ANRF, as of July 2016, 1,292 municipalities prohibit smoking in city parks, and 262 municipalities mandate smoke-free city beaches.

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

New York City's first non-smoking apartment building opened in late 2009. Many landlords and condominium associations in California, and in New York City, have also established smoke-free apartment policies. In 2013 Related Companies, which manages 40,000 rental units across the country, announced a ban on smoking for all new tenants. In July 2011 the San Antonio Housing Authority announced a ban, effective in January 2012, on smoking in its 6,175 rental units. Similar bans went into effect in 2012 for public housing in Boston and Minneapolis. The US Department of Housing and Urban Development in November 2015 announced plans to make all public housing smoke-free. The proposal would cover about 940,000 units. ANRF reports that there are 367 municipalities in the US that have enacted laws prohibiting smoking in all multi-unit housing.

New Jersey has prohibited smoking in college dormitories since 2005. At least 1,483 colleges nationwide now prohibit smoking everywhere on campus. In 2013 the California and Louisiana state college and university systems have banned tobacco use, joining Arkansas and Oklahoma with no-smoking restrictions at public colleges and universities, and Iowa, which prohibits smoking at all colleges and universities. Twenty-one states have banned smoking, indoors and outdoors, at state prisons. Since February 2015 smoking has been prohibited in all federal prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas, Virginia, and Rockland County, NY prohibit smoking in a car where there are children present, and similar legislation has been proposed in Connecticut, Florida, Illinois, Maryland, New York, Ohio, Oregon, Utah, Vermont, Virginia, and other states.

In June 2006, the Office of The Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke". It is a comprehensive review

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

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

In 2014, according to SAMHSA's National Survey on Drug Use & Health, 3.3% of adults used smokeless tobacco products. Among young adults, who had been more likely to use smokeless products, 2.0% used smokeless tobacco. A Massachusetts survey in 2011 found that 29% of male smokers aged 18-24 in snus test markets had tried snus products.

Advocates of the use of snuff as part of a harm reduction strategy point to Sweden, where "snus", a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men.[30] 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

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

higher quit rates than those who used other cessation aids.[31] A 2009 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.[32] Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[33] and the American Medical Association[34] (AMA) both conclude that nicotine is an addictive drug that produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

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

A significant issue before the FDA is the role of menthol cigarettes. It has been argued that menthol flavoring serves as an inducement to youth smoking and that its prevalence is especially high among minority groups, raising a call for a ban on its manufacture and sale. In an August 2016 letter. the African American Tobacco Control Leadership Council asked President Obama to direct the FDA to issue a proposed rule to remove all flavored tobacco products, including mentholated cigarettes, from the marketplace. Menthol cigarette sales represent approximately 30% of total cigarette sales. Moreover, menthol smoking rates have increased among young adults during the past decade. In September 2012 the American Journal of Public Health published the first peer-reviewed data on menthol smokers. It reported the results of a national survey of those smokers showing that nearly 40% of menthol smokers say they would quit smoking if menthol cigarettes were no longer available. While an outright ban would no doubt prompt a significant number of these smokers to switch to other brands, any significant amount of quitting as a result would have a large negative effect on total consumption and sales. This survey suggests that the effect might be as large as a 12% reduction in cigarette consumption. In 2011, the FDA's Tobacco Products Scientific Advisory Committee

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[31] 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.
[32] Tomar, Alpert, and Connolly, "Patterns of Dual Use of Cigarettes and Smokeless Tobacco among US Males: Findings from National Surveys". Tobacco Control. 11 December 2009.
[33] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".
[34] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes," Report to the AMA House of Delegates, June 1998.

("TPSAC") determined that menthol use is most prevalent among younger smokers, and among African Americans. It concludes that the availability of menthol cigarettes more likely than not: 1) increases experimentation and regular smoking, 2) increases the likelihood and degree of addiction in youth smokers and, 3) results in lower likelihood of smoking cessation success in African Americans. The FDA, in July 2013, released its review, "Preliminary Scientific Evaluation of the Possible Public Health Effects of Menthol Versus Nonmenthol Cigarettes". It concluded that menthol in cigarettes is likely to be associated with, first, altered physiological responses to tobacco smoke, second, increased dependence, third, reduced success in smoking cessation, and fourth, increased smoking initiation by youth. Though the report did not constitute a decision about regulatory action, the FDA did conclude that it is likely that menthol cigarettes pose a public health risk above that seen with nonmenthol cigarettes. In August 2013 the American Academy of Family Physicians advocated a menthol ban in an open letter to the Food and Drug Administration. And in November 2013 twenty-five state attorneys general asked U.S. public health regulators to ban menthol cigarettes. No regulatory action was taken in 2014 or 2015. Reynolds has continued to contest the FDA's report.

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

Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue.

Plain packaging, absent brand names has also been as a tobacco control policy. Australia, in 2001 introduced plain-packaging requirements. A recent study concluded that a significant decline in smoking prevalence followed the introduction of plain packaging

(3.7% over 2001-2013), after adjusting for the impact of other tobacco control measures.[35]

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

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

An Empirical Model of Cigarette Consumption

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

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

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with IHS Global Insight's standard population growth forecast, we projected actual cigarette consumption (in billions of cigarettes) out to 2052. 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 2015 on the variables described above, we developed the following regression equation.

log (per capita consumption) = 54.1

- 0.024 * trend

- 0.223 * log (cigarette price)

- 0.104 * log (cigarette price last year)

+ 0.274 * log (per capita disposable income)

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

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

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2014 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

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

Forecast Assumptions

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

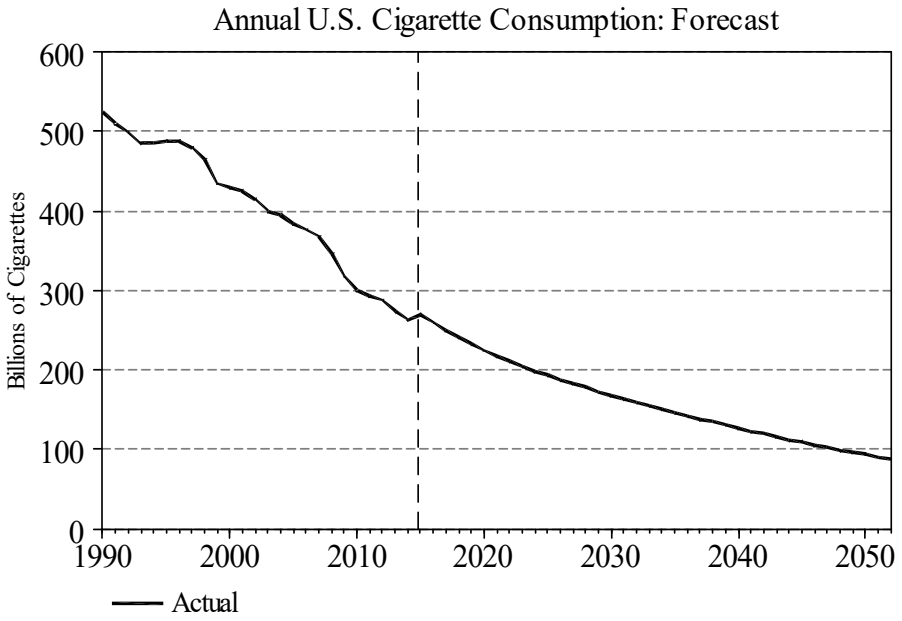
The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the MSA and other state settlement agreements and subsequent excise tax increases. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, to $4.04 in 2005, to $4.18 in 2006, $4.47 in 2007, $4.75 in 2008, and to $5.99 in 2009, $6.62 in 2010, $6.85 in 2011, $7.00 in 2012, $7.19 in 2013, $7.40 in 2014, and $7.60 in 2015. Our forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. Relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

President Obama's 2017 federal budget proposal included an increase in the Federal Excise Tax to $1.95 per pack. Our model predicts that, if enacted, the tax increase would reduce cigarette consumption by an additional 4.5%, resulting in a total decline of approximately 8% in the first year after enactment.

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

Forecast of Cigarette Consumption

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



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

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

In 2013, shipments reported by MSAI were 4.6% lower than in 2012. For the full year US Tobacco and Tax Bureau (TTB) reported shipments 4.8% lower than in 2012. Weak per capita disposable income growth was responsible for part of the decline. In addition

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

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

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

RAI in its 2016 third quarter report indicates that industry shipments were 195.7 billion cigarettes, a 1.8% decline from the first three quarters of 2015. After adjusting for inventory movement, Altria reports estimates that underlying consumption in the quartere was about 3.4% below that of 2015. TTB data for July indicates a 4.7% decline for the year through July.

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

From 2016 through 2052 the average annual rate of decline is projected to be 3.0%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	Decline Rate	Consumption including Roll-Your-Own	Decline Rate
	(billions)	*(%)*	*(billions)*	*(%)*
2011	293.3	-2.5%	296.0	-2.7%
2012	287.9	-1.9%	290.1	-2.0%
2013	274.4	-4.7%	276.2	-4.8%
2014	264.1	-3.8%	265.7	-3.8%
2015	269.0	1.9%	270.8	1.9%
FORECAST				
2016	259.7	-3.5%	261.4	-3.5%
2017	250.4	-3.6%	252.0	-3.6%
2018	241.4	-3.6%	243.1	-3.6%
2019	233.0	-3.5%	234.6	-3.5%
2020	225.2	-3.4%	226.7	-3.4%
2021	217.8	-3.3%	219.2	-3.3%
2022	210.9	-3.1%	212.4	-3.1%
2023	204.6	-3.0%	205.9	-3.0%
2024	198.7	-2.9%	200.0	-2.9%
2025	193.2	-2.8%	194.5	-2.8%
2026	187.9	-2.7%	189.2	-2.7%
2027	182.9	-2.7%	184.2	-2.7%
2028	178.1	-2.7%	179.3	-2.7%
2029	173.3	-2.7%	174.5	-2.7%
2030	168.6	-2.7%	169.8	-2.7%
2031	164.1	-2.7%	165.2	-2.7%
2032	159.7	-2.7%	160.8	-2.7%
2033	155.3	-2.7%	156.4	-2.7%
2034	151.0	-2.8%	152.0	-2.8%
2035	146.8	-2.8%	147.8	-2.8%
2036	142.7	-2.8%	143.7	-2.8%
2037	138.7	-2.8%	139.6	-2.8%
2038	134.8	-2.8%	135.7	-2.8%
2039	130.9	-2.9%	131.7	-2.9%
2040	127.1	-2.9%	127.9	-2.9%
2041	123.4	-2.9%	124.2	-2.9%
2042	119.8	-2.9%	120.6	-2.9%
2043	116.2	-3.0%	117.0	-3.0%
2044	112.7	-3.0%	113.5	-3.0%
2045	109.4	-3.0%	110.1	-3.0%
2046	106.1	-3.0%	106.8	-3.0%
2047	102.9	-3.0%	103.6	-3.0%
2048	99.8	-3.0%	100.4	-3.0%
2049	96.7	-3.0%	97.4	-3.0%
2050	93.8	-3.0%	94.4	-3.0%
2051	91.0	-3.0%	91.6	-3.0%
2052	88.2	-3.0%	88.8	-3.0%

Comparison With Prior Forecasts

In February 2006 IHS Global, then Global Insight presented a similar study, "A Forecast of U.S. Cigarette Consumption (2004-2042) TSASC, Inc. That report projected consumption in 2042 of 199.0 billion cigarettes, reflecting an average decline rate of 1.8%. Through 2006, the 2005 study accurately projected consumption declines, but the sharp acceleration in the decline rate thereafter resulted in a substantial forecast error. The current forecast projects an average decline rate of 3.0% through 2042, to an annual consumption level of 119.8 billion sticks. The new forecast was developed with consideration of the large federal tax increase in 2009 and of the negative effects of the proliferation on smoking ban legislation across the US.

APPENDIX A-2

IHS GLOBAL TRIBAL SALES REPORT

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Cigarette Purchases by New York Consumers from Tribal Retailers in New York State

Submitted to:

TSASC, Inc.

Prepared by:

IHS Global Inc.

November 7, 2016

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Disclaimer

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

Executive Summary

IHS Global has developed a cigarette sales model which estimates and projects the sales of tribal cigarettes at tribal shops in New York. This model, coupled with our long-term forecast of the U.S. cigarette consumption and our demographic forecast of New York State Counties, have been used to project tribal cigarette sales in New York from 2015 through 2052. We estimate that a total of 54.2 million packs were sold by reservation retailer to non-tribal consumers in 2015, and forecast that tribal cigarette sales to non-tribal consumers will fall by 75 percent to 13.5 million packs by 2052.

We also present two alternative—one high and one low—scenarios where cigarette sales could have been as high as 65.2 million packs, or as low as 43.3 million packs in 2015. In these alternate scenarios, we vary the impact on the demand for tribal brand cigarettes driven by the price differential received by non-tribal consumers.

Our model was constructed based on widely accepted economic principles and IHS Global's considerable experience in building econometric forecasting and simulation models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning cigarette demand. It also accords with standard economic models of consumer spending at retail locations. In this case we explicitly account for smokers travel time to tribal shops and their consumer choice among brands as a function of price differentials. We are careful to parameterize the model based on the most reliable survey research available.

Introduction

The purpose of this report is to estimate the sales of cigarettes at tribal stores on Native American reservations in New York State. In particular, we are interested in sales of cigarettes manufactured by non-participating manufacturers (NPMs) under the Master Settlement Agreement (MSA) that are sold to non-tribal members free of State and local cigarette and sales taxes and without regard to the State's minimum cigarette price standards. Such cigarettes are referred to herein as "tax-free tribal NPM cigarettes".

Tax-free Tribal NPM Cigarette Sales at New York Tribal Stores

There are nine Native American tribes or nations (referred to herein for convenience as tribes) in New York State that are recognized by either the federal or State government, with a total of eleven recognized Native American reservations or other tribal land areas (for convenience all referred to herein as "reservations") from which the tribes or their members sell tax-free tribal NPM cigarettes to non-tribal consumers. Two of the tribes, the Unkechaugs and the Shinnecocks, have reservations (respectively, Poospatuck and Shinnecock) in Suffolk County on the eastern end of Long Island. The Seneca Nation of Indians has three reservations, Allegany, Cattaraugus, and Oil Springs, in Western New York south of Buffalo. Part of the Cattaraugus reservation is in southwestern Erie County and is traversed by the New York State Thruway (I-90). Two other tribes, the Tonawanda Band of Senecas and the Tuscarora Nation, also have reservations in western New York, northeast and north of Buffalo. The reservations of three tribes, the Cayugas, the Oneidas and the Onondagas, are in central New York, within an hour's drive from the Syracuse area. The Tonawanda reservation to the west and the Cayuga reservation to the southeast are within an hour's drive from much of Rochester area. The St. Regis Mohawk Tribe reservation borders the St. Lawrence River and Canada in the north-central part of the State, and a portion of the reservation is in Canada. These reservations are indicated on the map below.

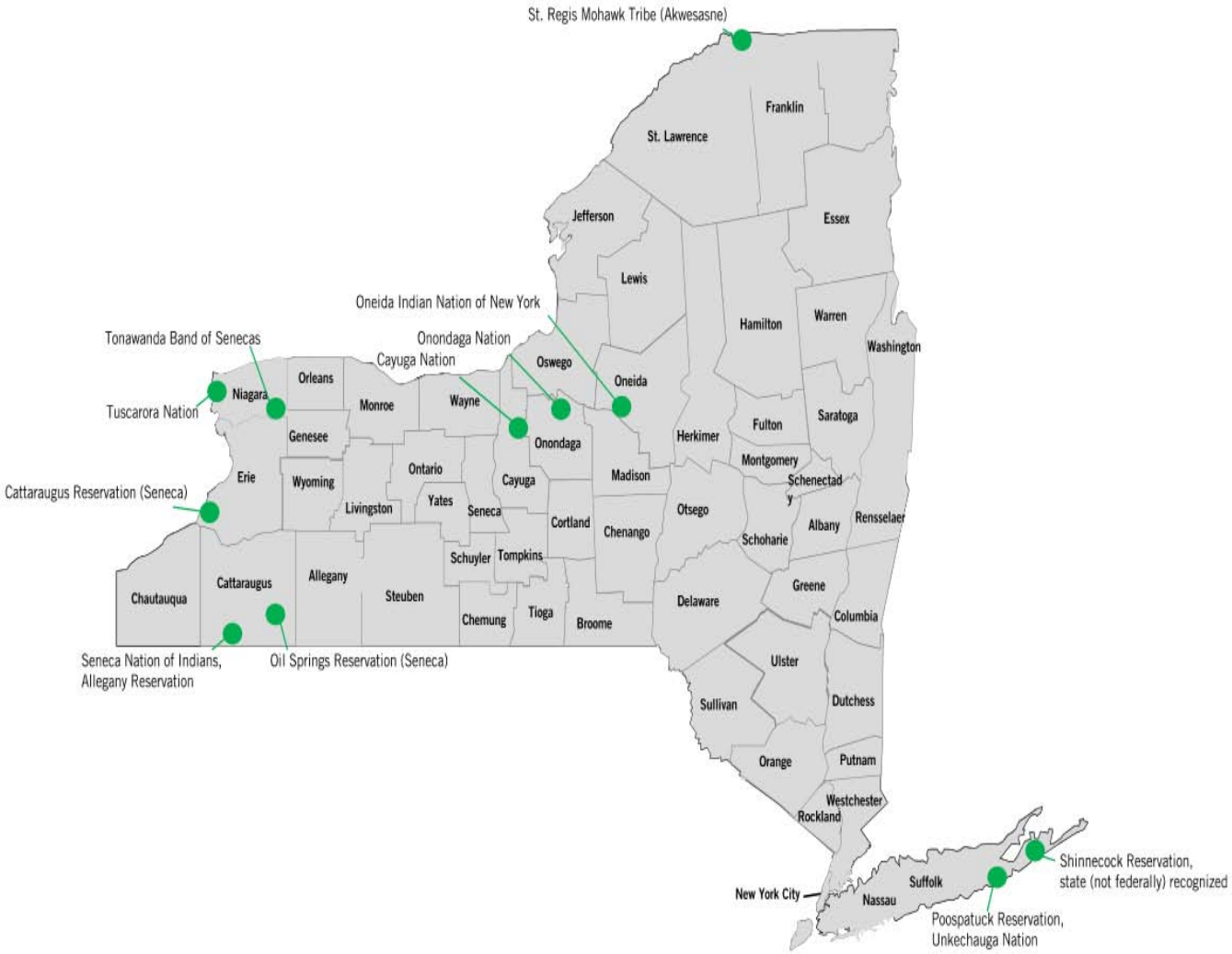
Based on information available from public sources, including the Internet, the number of retail vendors offering tax-free tribal brand cigarettes on each reservation ranges from one (in the case of the Onondaga reservation) to 21 in the case of the St. Regis Mohawk reservation, as shown in the table below:

Table 1

Reservation	Number of retail vendors selling tribal brand cigarettes
Cattaraugus	11
Cayuga	2
Oil Springs	2
Oneida	17
Onondaga	1
Poospatuck	6
St. Regis Mohawk	21
Shinnecock	8
Tonawanda	10
Tuscarora	5
Total	**83**

Tribal shops now sell tax-free tribal NPM cigarette brands for approximately $2 to $4 per pack (or approximately $20 to $40 per carton), considerably less than the approximately $9.00 average price, including all State and local taxes, observed at New York convenience stores for discount brands of participating manufacturers under the MSA. Prices appear to be lowest on reservations with numerous outlets selling tribal cigarettes. Fully-taxed premium brands typically sell for more than $10 per pack ($100 per carton) in New York State outside of New York City. The fully-taxed price under New York State minimum price regulations for Marlboro cigarettes is $9.57 per pack ($11.23 in New York City).

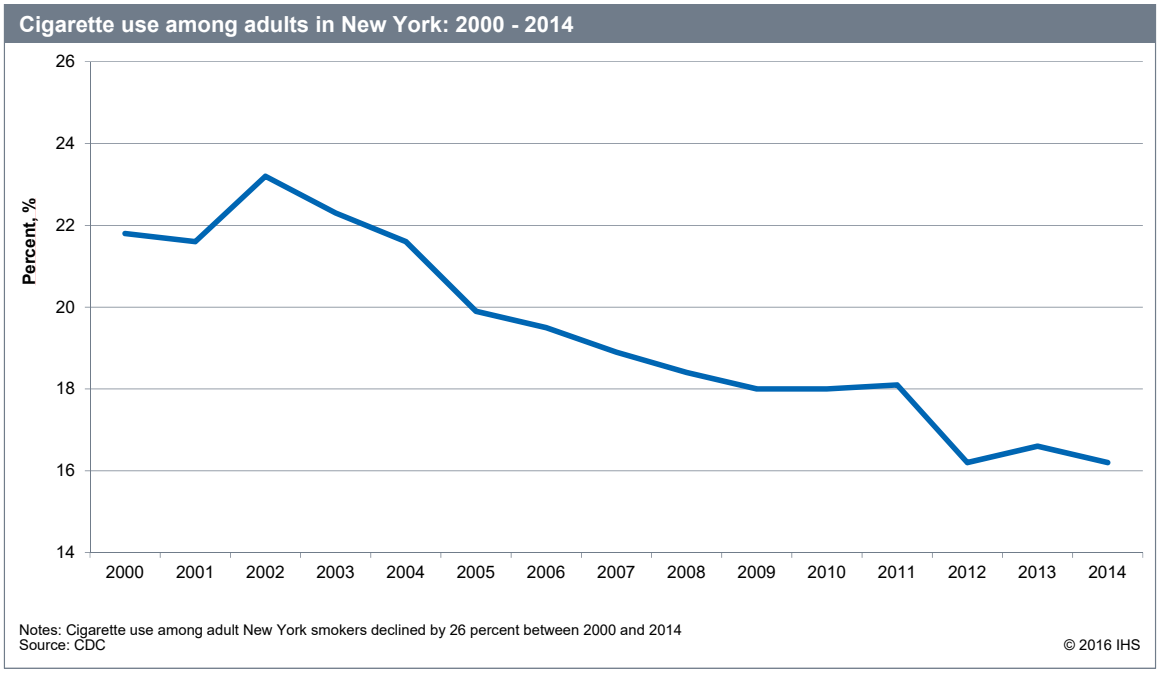
Map of NYS Native American Reservations



Cigarette Consumption and Sales in New York State

The portion of the population in New York State that smokes has declined over the last few decades along with the rest of the country. In New York, the CDC has estimated that in 2014[1] the percentage of adults (aged 18 and above) who smoked cigarettes was 16.2 percent. The rate of decline in smoking prevalence in New York and the nation has been especially sharp since 2002. At that time prevalence was estimated at 22.5 percent in the U.S. and 22.3 percent in New York. Across all states the prevalence of cigarette smoking among adults in 2012 ranged from 11.8 percent to 29.0 percent. The U.S. average in 2014 was 16.8[2] percent versus 16.2 percent in New York State. It ranged across states in 2014 from 9.7 percent to 29.2 percent. The CDC margin of error (or confidence interval) for this estimate is +/- 0.2 percentage points, which will be used in translating a statistical confidence interval for some of our estimates.

Figure 1

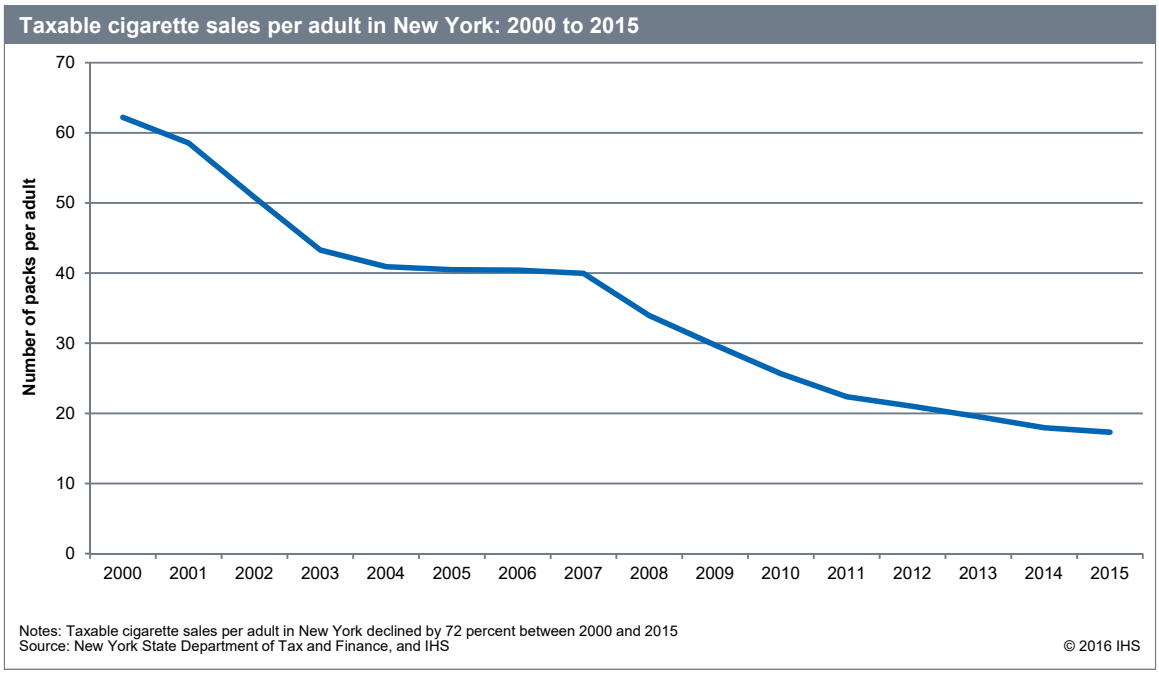


Meanwhile, New York State's taxable cigarette sales have been declining at a faster rate, from over 55 packs per year per capita in 2000 to less than 17 packs this decade.

[1] *Source*: CDC.

[2] The CDC has published US incidence statistics for 2015, but for this comparison we use the 2014 estimate as it is the latest year for which state data is available

Figure 2



Assuming that average cigarette consumption among New York's smokers is consistent with national cigarette consumption data[3], that is that smokers in New York consume the same number of cigarettes on average as do all U.S. smokers, it is clear that cigarette sales subject to New York excise taxes have fallen well short of the number of cigarettes consumed in New York, even after adjusting for the lower prevalence of smoking among New Yorkers. Based on the CDC-reported 16.2 percent smoking prevalence in New York, we would expect annual consumption in the State to be 46.3 packs per capita.

Since 2000, per capita U.S. cigarette sales have fallen by 48 percent as smoking prevalence has fallen by 28 percent. At the same time, while New York smoking prevalence, always less than that of the nation, has declined by a similar amount, 26 percent, taxable sales have fallen by a far larger amount, 73 percent. Our conclusion, also supported by other research as well, is that a large share of cigarette use in New York State is with cigarettes which evade New York's highest in the nation state cigarette tax.

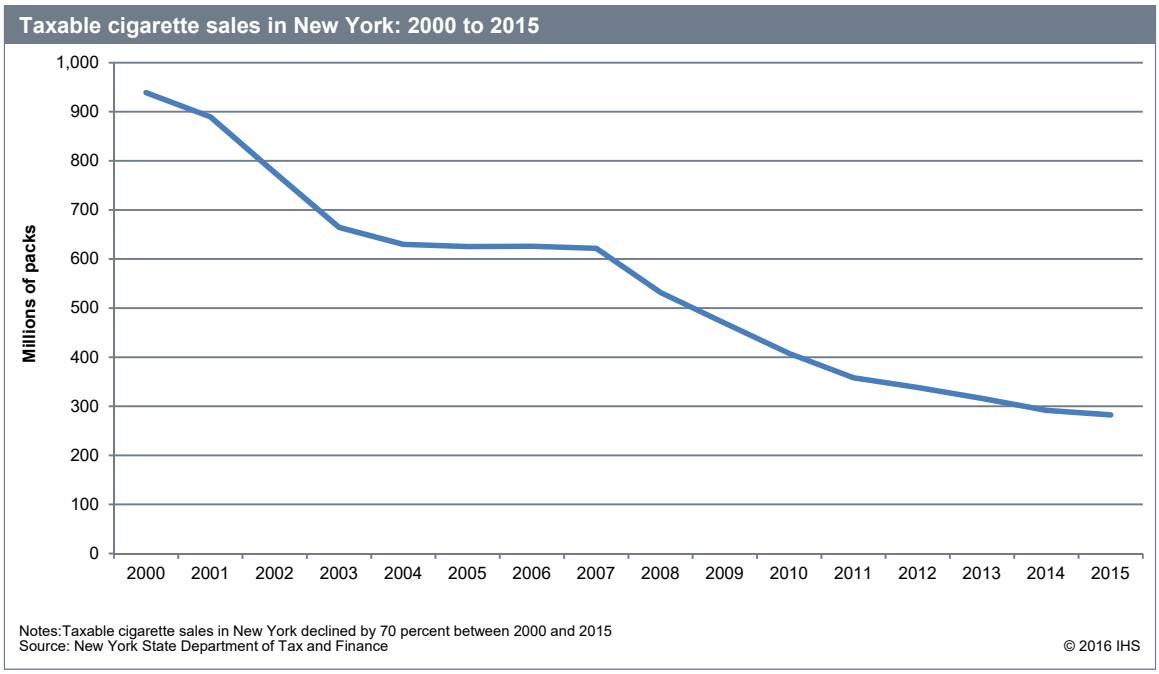
[3] This assumption may result in the estimate of New York State cigarette consumption used in this report to be somewhat overstated since cigarette prices (including taxes) tend to reduce both smoking prevalence (percentage of the population that smokes) and the number of cigarettes each smoker consumes (per capita consumption) and prices in New York are higher than those nationwide data.

Excise Taxes on Cigarette Purchases in New York State

Residents of New York State, and particularly New York City, face some of the highest excise taxes on cigarettes and on other tobacco products in the country. Between January 1, 2000 and July 1, 2010, the State cigarette tax was raised four times from $0.56 per pack to $4.35 per pack. The City of New York has imposed an additional tax of $1.50 per pack since 2002.

One result has been that taxable sales in New York State following the significant State cigarette excise tax increases in 2008 and in 2010 have fallen dramatically in this decade. Figure 3 displays taxable cigarette sales reported by the New York Department of Tax and Finance. The tax increase to $2.75 in 2008 and to $4.35 in 2010 would have been expected to cause a decline of approximately 11 percent as a direct effect of higher prices on consumption.

Figure 3

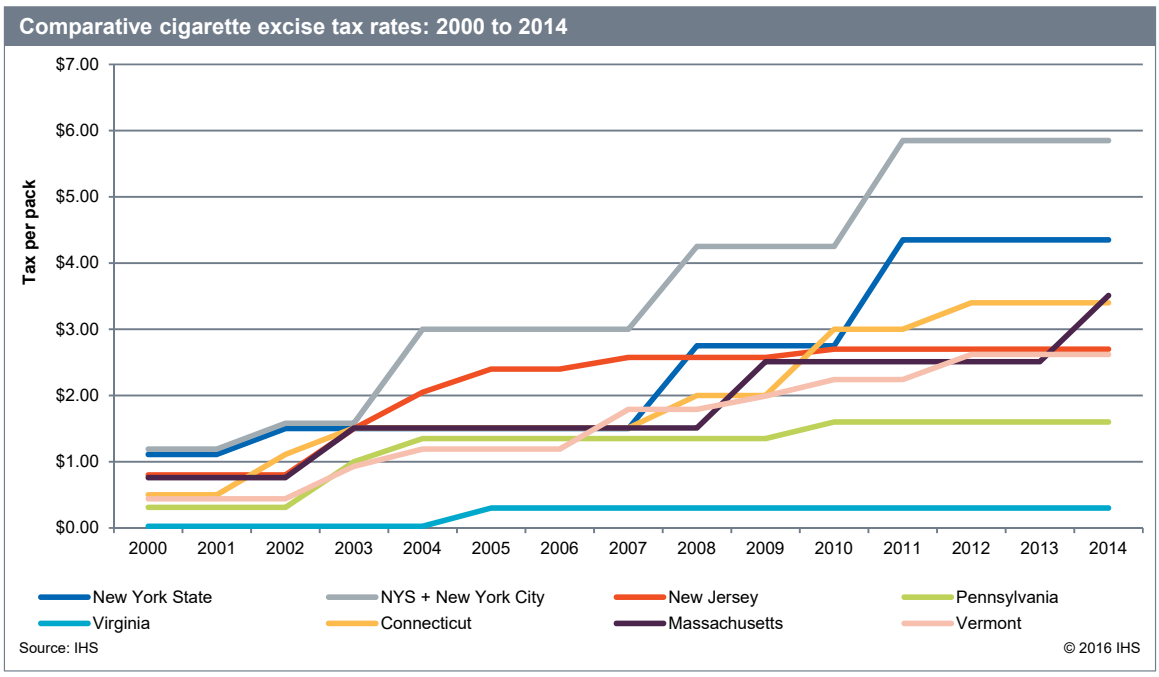


Unsurprisingly, many New York smokers find ways to avoid paying the high cigarette taxes by purchasing cigarettes from sources that have not paid New York State taxes and, where applicable, New York City taxes. New York smokers may access the premium and discount cigarettes produced by the PMs from stores and retail outlets located in low-tax states, and duty free shops in airports or along the Canadian border, and reportedly, from the many retail stores and street vendors in New York City who sell at lower prices illegal smuggled cigarettes. They also can drive to a store on any one of the 10 Indian reservations in the State (excluding the Oneida reservation) to purchase tax-free cigarettes manufactured by NPMs located on Indian reservations in the State and elsewhere. On the Oneida reservation, such reservation manufactured cigarettes are also available at a cost (as low as about $60 per carton) well below that charged for premium brands, even with the addition of an Oneida Nation cigarette tax equivalent to the New York State tax. A 2015 study by the Mackinac Center for Public Policy and the Tax Foundation concluded that New York State has the highest inbound smuggling rate nationwide (with inbound

smuggling in this case including the cigarettes sold tax-free on the reservations), with illegally imported or untaxed tribal cigarettes making up 58 percent of the State's total market in 2013.

While certain neighboring states also impose high cigarette taxes compared to the lowest tax states (such as Virginia), these rates are all well below the New York State tax rate as shown below.

Figure 4



New York smokers who cross the border and purchase participating manufacturer (PM) brand cigarettes from nearby New Jersey save $1.65 per pack in taxes ($3.15 per pack if they would otherwise buy in New York City legally). Crossing the border to Pennsylvania results in an even higher savings of $2.75 per pack of avoided State tax (and $4.25 per pack if they would otherwise buy legally in New York City) on PM brands [4]. Similar considerations apply to more distant states, especially Virginia, which is accessible by motor vehicle on Interstate 95 for smokers (and smugglers) in the New York City metropolitan area. It is worth noting that under New York State law, there is no cigarette tax requirement "on the use of four hundred or less cigarettes, brought into the state on, or in the possession of, any person". (New York State Tax Law Section 471-a.) This provision, however, does not apply to purchases of untaxed cigarettes on reservations within the State, another potential alternative source of lower-cost cigarettes.

[4] Effective August 1, 2016, the State of Pennsylvania increased the excise tax per pack of cigarettes by $1 to $2.60. In addition, lawmakers in Connecticut increased the tax by $0.25 to $3.90 per pack effective July 1, 2016.

The History of Tribal Cigarette Sales

For many years prior to 2011, New York State officially allowed its State-licensed cigarette tax stamping agents to sell unlimited quantities of untaxed cigarettes wholesale to cigarette sellers on reservations in the State from all manufacturers. The State-licensed cigarette tax stamping agents, who purchase cigarettes from manufacturers and apply pre-paid State tax stamps, are the only legal wholesalers of cigarettes in the State. Under this broad forbearance policy (which ended in June 2011), the total number of cigarette cartons sold to Native American reservations in New York grew from 5.7 million in 1988 to 47.6 million in 2005—a 735 percent increase, before declining over the next several years. These purchases clearly exceeded tribal consumer demand suggesting that most cartons obtained through State stamping agents were sold to non-tribal members, including to smokers outside New York via the Internet, mail order, or phone order. For example, in 2008, cigarette vendors based on the Poospatuck reservation, which had a population of 376, purchased more than 8.4 million cartons of cigarettes equating to each tribal member purchasing 614 packs (12,280 cigarettes) per day. By 1999, researchers had identified 43 Internet vendors based in New York State selling cigarettes, most of which were on Indian reservations in western New York. Two years later, the State tax department identified over 80 Internet vendors based in western New York[5].

The State recognized the high degree of excise tax evasion and engaged in periodic attempts to enforce the tax laws. In 2005-06 the New York State Attorney General entered into agreements with FedEx, UPS and DHL to curtail shipment of cigarettes bought online which had been prohibited by State law since 2000. And the federal Prevent All Cigarette Trafficking (PACT) Act enacted in 2010 outlawed the shipment of unstamped cigarettes, and also required that tax stamps be affixed to cigarette packs by wholesalers before they were shipped to Indian reservations. Thus, beginning in 2005 greater enforcement by state authorities curtailed Internet sales, and New York State and federal legislation effectively eliminated them by June 2011. Since June 2011, existing inventories of premium brands were sold, and tax-free sales from reservations have been limited to on-site sales of tribal NPM brand cigarettes.

Tables 2 and 3 display cigarette sales to Indian nations from PMs and other off-reservation manufacturers as reported to the New York State Department of Taxation and Finance by State cigarette tax stamping agents between 2000 and 2011. Despite the fact that the State has no record of major label PM brands being shipped legally to reservations by State stamping agents since mid-2011, some tribal shops continue to sell these brands. A 2012 report published by the Roswell Park Cancer Institute (RPCI) found that 12 out of 15 reservation shops surveyed sold at least one major label brand (Marlboro or Newport)[6]. In April 2016 we observed that at least one shop on the Seneca Nation's Cattaraugus reservation, south of Buffalo, was selling Marlboro brand cigarettes at $6.50 per pack. The source and the quantity of these major label PM brands sold in tribal shops in the State is not known. For purposes of this report, we have assumed that all tax-free sales from the tribal cigarette outlets on reservations in the State are of tribal NPM cigarettes purchases on premises.

[5] New York State Department of Taxation and Finance (2009).
[6] *Source*: Roswell Park Cancer Institute. Hyland, Smith, Fix, and Rivard (March 2012).

Table 2

Comparison of Sales to Indian Reservations and New York State Tax Stamp Sales: 1984 to 2015				
	Reported Cigarette Sales to Indian Nations (Cartons)	NYS Tax Stamp Sales (Cartons)	Total Reported Volume of Cigarettes Shipped into NYS (Cartons)	Indian Share of Total Reported NYS Volume
1984	1,043,959	210,432,600	211,476,559	0.5%
1985	1,843,690	206,580,100	208,423,790	0.9%
1986	3,075,176	196,443,600	199,518,776	1.5%
1987	4,217,536	191,960,600	196,178,136	2.1%
1988	5,650,368	186,357,900	192,008,268	2.9%
1989 (a)	7,645,096	170,987,100	178,632,196	4.3%
1990 (b)	9,957,994	162,874,100	172,832,094	5.8%
1991	10,623,684	151,839,100	162,462,784	6.5%
1992	14,249,497	145,385,000	159,634,497	8.9%
1993 (c)	14,478,467	134,387,615	148,866,082	9.7%
1994	15,688,785	128,339,900	144,028,685	10.9%
1995	19,800,720	123,140,460	142,941,180	13.9%
1996	20,088,425	118,136,090	138,224,515	14.5%
1997	20,061,414	117,459,480	137,520,894	14.6%
1998	15,213,878	118,190,080	133,403,958	11.4%
1999	15,558,379	112,308,880	127,867,259	12.2%
2000 (d)	20,746,460	93,899,080	114,645,540	18.1%
2001	22,462,975	88,953,360	111,416,335	20.2%
2002 (e)	28,006,531	77,591,520	105,598,051	26.5%
2003	39,343,397	66,441,480	105,784,877	37.2%
2004	47,363,097	62,991,240	110,354,337	42.9%
2005	47,605,054	62,533,200	110,138,254	43.2%
2006	36,014,537	62,588,760	98,603,297	36.5%
2007	31,940,366	62,184,984	94,125,350	33.9%
2008 (f)	27,513,045	53,191,080	80,704,125	34.1%
2009	24,033,538	46,916,640	70,950,178	33.9%
2010 (g)	23,358,025	40,773,720	64,131,745	36.4%
2011	9,581,851	35,802,000	45,383,851	21.1%
2012	0	33,819,000	33,819,000	0.0%
2013	0	31,605,000	31,605,000	0.0%
2014	0	29,175,000	29,175,000	0.0%
2015	0	28,242,720	28,242,720	0.0%

a) Cigarette tax rate increased from 21 cents to 33 cents per pack on 5/1/1989
b) Cigarette tax rate increased from 33 cents to 39 cents per pack on 6/1/1990
c) Cigarette tax rate increased from 39 cents to 56 cents per pack on 6/1/1993
d) Cigarette tax rate increased from 56 cents to $1.11 per pack on 3/1/2000
e) Cigarette tax rate increased from $1.11 to $1.50 per pack on 4/2/2002, and the New York City cigarette tax rate increased from 8 cents to $1.50 on 7/2/2002
f) Cigarette tax rate increased from $1.50 to $2.75 per pack on 6/3/2008
g) Cigarette tax rate increased from $2.75 to $4.35 per pack on 7/1/2010

Table 3 **Sales to Native American Nations as Reported by State Stamping Agents Ranked by Total Sales Volume (cartons) 1996-June 2015**

	Indian Nation								
Year	Seneca	Unkechaug (Poospatuck)	Tonawanda	Tuscarora	Oneida[1]	Onondaga	Shinnecock	St. Regis Mohawk	Cayuga
1996	7,243,495	406,148	3,239,717	3,503,075	1,149,565	2,053,982	1,021,473	1,443,959	-
1997	10,093,605	362,804	2,783,814	2,850,618	792,803	1,422,350	771,969	979,125	-
1998	6,580,620	611,430	2,662,340	2,306,733	789,923	703,250	750,072	802,589	-
1999	5,717,238	1,047,140	2,700,097	2,040,078	1,330,283	1,156,728	696,971	852,344	-
2000	6,265,565	444,643	3,595,878	4,835,751	1,332,637	1,499,974	2,129,653	639,865	-
2001	9,428,926	680,035	3,972,924	3,331,270	1,294,383	1,370,508	1,832,502	526,825	-
2002	14,563,668	952,340	4,522,550	2,480,306	1,259,108	1,337,782	2,066,428	601,544	-
2003	23,963,563	811,899	4,496,889	2,704,786	1,085,060	1,364,602	2,595,677	777,090	-
2004	29,813,680	4,978,931	4,174,047	3,028,342	1,856,768	1,265,274	1,388,666	861,884	-
2005	27,505,847	7,886,663	4,080,130	2,761,818	2,106,062	1,131,415	1,454,928	715,742	-
2006	17,677,150	8,888,129	2,453,889	1,863,831	2,777,496	917,646	362,871	1,073,529	-
2007	12,559,554	11,316,773	2,000,376	1,635,751	2,642,851	789,434	330,316	665,311	-
2008	11,811,732	8,425,202	2,028,773	1,500,597	1,608,076	1,067,585	281,247	789,833	-
2009	10,256,765	5,286,995	2,890,713	1,349,820	1,566,056	1,167,010	223,398	1,292,781	-
2010	7,334,451	6,870,738	2,990,146	1,792,343	1,248,997	1,034,704	259,953	1,640,834	185,860
2011	1,877,515	3,000,086	2,457,247	679,927	280,266	184,333	88,303	913,909	100,266
2012	-	-	-	-	-	-	-	-	-
2013	-	-	-	-	-	-	-	-	-
2014	-	-	-	-	-	-	-	-	-
2015	-	-	-	-	-	-	-	-	-
Total	202,693,374	61,969,956	51,049,530	38,665,046	23,120,334	18,466,577	16,254,427	14,577,164	286,126

Source: State Tax Dept.

Estimating the Missing Cigarette Sales

In 2012, John Dunham and Associates (JDA) performed a multi-segment demand analysis for the New York Association of Convenience Stores and estimated that New York residents likely purchased 38.2 packs per capita in 2011. JDA's results suggest that total demand in New York was approximately 738.4 million packs in 2011, with just under half, 354.4 million packs, purchased from sources selling cigarettes on which New York State taxes had been paid. The remaining 384 million packs came from alternative sources such as cross-border sales, illegal bootlegging, untaxed internet sales, sales on Native American reservations, sales at military bases, and sales at duty free shops. JDA estimated that in 2011 approximately 70.5 million packs (or 18 percent of sales from alternative sources) were sold on Native American reservations to non-tribal consumers in on premise sales[7]. Given the inability of tribal outlets to legally purchase wholesale untaxed premium brands for resale after June 2011, we estimate that more recent tribal sales are significantly less than JDA's estimates of sales in 2011.

The factors affecting the composition of the missing packs have changed significantly over the last 20 years. First, New York and other states have had multiple tax rate changes over the past two decades, so that the relative incentive for out-of-state purchases has shifted among states. Second, the rapid rise in internet e-commerce usage also played a large role beginning in the late 1990s. But in recent years, the impact of cigarette sales from Internet-based retail outlets has decreased. New York State credit card companies began in 2005 to restrict use of their credit

[7] *Source*: John Dunham and Associates (2012).

for cigarette purchases, and shipping companies began to reject cigarette shipment orders. The PACT Act required the collection of federal, state, and local taxes on cigarettes sold via the internet or other mail-order sales[8]. Third, New York State prohibited State cigarette tax stamping agents from selling untaxed cigarettes to tribal outlets, since 2011.

We have performed calculations similar to the JDA study for 2015. Starting from U.S. consumption of 269 billion cigarettes in 2015, we take New York's share of the adult population, deflated by the relative smoking prevalence difference as measured by the CDC, to conclude that New Yorkers likely consumed 761 million packs in 2015. With State tax revenues indicating taxable sales of 289 million packs[9], this is a shortfall of 62 percent.

To illustrate one source of the missing cigarettes, consider the impact of New York excise tax increases in 2008 to $2.75 and in 2010 to $4.35. In the two years after the 2010-rate increase, we observe taxable New York sales fall by 20 percent in New York, while sales increased in New Jersey by 4.3 percent, in Pennsylvania by 2.6 percent, and in Virginia by 9.6 percent. As none of these states changed tax rates at this time, and as the consistent trend in their excise tax collections had been negative in line with general U.S. smoking declines, it is clear that a large amount, roughly estimated at 270 million packs, of cigarettes represented increased out-of-state purchases by New York residents. Other low-tax states such as South Carolina may also have contributed to New York sales, but its numbers are likely to be small compared with states nearby.

It is possible to attempt to estimate from information about other State excise tax collections a residual amount of 'missing' cigarettes which could be attributed to purchases by New York State consumers at tribal shops. Estimates of the number of missing New York cigarettes range from 300 million to 500 million packs, based upon the gap between the reported taxable sales in the State in 2015 and the margin of error in our estimate of consumption for the year [10]. The margin of error of an estimate of inter-state sales is nearly 100 million packs. And thus, any estimate on the residual due to tribal sales would be subject to a similar error of up to 100 million packs. If the missing cigarettes are assumed to be 400 million and out-of-state sales known to be 375 million, we would conclude that tribal sales were 25 million – however, they might, given the margin of error in the first number, be as high as 125 million packs (500-375 million).

The National Academies Press, in 2015, published a comprehensive review, "Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences", in which they offered a set of 'best practices' for estimating the size of the illicit market[11]. They include the procedures described above (analyzing missing cigarettes from estimated consumption in excess of taxable sales), but also a random sampling of discarded cigarette packs from which the absence of tax stamps is noted.

We note that a 2013 littered pack survey conducted in five northeastern cities – Boston, New York City, Philadelphia, Providence, and Washington, DC – found that 15.7 percent of packs collected did not have a tax stamp. Since cigarettes sold on Indian reservations do not have tax stamps, it was concluded that a significant share (noting that North Carolina and South Carolina also do not affix stamps and may have been a source) of the collected packs were likely reservation purchases. We also reviewed the results of a 2015 littered pack survey conducted in 30 census tracts in the South Bronx area in March 2011, March 2012, and March 2013. The authors

[8] *Source*: John Dunham and Associates (2012).
[9] New York State Department of Tax and Finance.
[10] The JDA study estimated it to be 384 million in 2012. Chaloupka et al. estimated 318 million study of littered packs in 2012.
[11] *Source*: P. Reuter and M. Majmundar (2015).

reported that the following shares of collected packs did not have a tax stamp, and were possibly reservation purchases: 42 percent in 2011, 8.8 percent in 2012, and 6.2 percent in 2013. The timing of this significant reduction in unstamped packs coincides with the June 2011 change in New York State policy discontinuing the availability of untaxed cigarettes for wholesale purchase by reservation retailers from State stamping agents. In both studies the authors do not report the share of tribal brand packs, if any, collected.

Until 2011, a considerable amount of untaxed premium brand cigarettes from major manufacturers were shipped wholesale by State stamping agents to tribal outlets many of whom took orders online. Both online tax-free sales of premium brands and tax-free sales of premium brands at Indian smoke shops were curtailed when the State ceased to allow its stamping agents to sell unlimited quantities of premium brands and other PM cigarettes tax-free. The tribal shops now sell predominantly tribal manufactured brands directly at tribal outlets. An exception, though, is a separate agreement with the Oneida Nation, which permits the Oneidas to buy premium brand and tribal-made cigarettes tax free, and to sell this full line of cigarettes to any New York consumer so long as the Oneidas impose an Oneida Nation tax that is equivalent to the New York State excise tax.

Estimating Tribal Cigarette Sales to New York Consumers

We employ a "bottom-up" approach to estimate tribal cigarette sales to non-tribal consumers based on their proximity to a Native American reservation.

The IHS Global Regional Economic Service forecasts County-level population by age category and by state. We use the forecasts of New York State's population aged 15 and above[12] to estimate cigarette purchases by non-tribal consumers from tribal stores as follows:

$$\Sigma(Cig_c) = \beta_c * D_c * (P_c/P_N) * S_N$$

where,

Cig_c = Purchases of cigarettes by non-tribal consumers from tribal stores in a given county. $\Sigma(Cig_c)$ is the sum of estimated tribal purchases of cigarettes from all Counties in New York and the City of New York

β_c = Estimated share of smokers who visit tribal stores regularly to purchase cigarettes in a given County

D_c = Estimated demand for tribal discount cigarettes based on the estimated price differential received by non-tribal consumers who purchase cigarettes from tribal stores

(P_c/P_N) = County's share of the total population in New York, where P_c is the County population and P_N is the New York State population

S_N = Estimate of total packs of cigarettes, taxed and untaxed, sold in New York

The incidence of cigarette purchases by non-tribal consumers from tribal stores depend on three key factors—the consumers' willingness and ability to travel to a reservation, the potential discount received by purchasing cigarettes from tribal stores, and consumers' brand loyalty and demand elasticity for cigarettes.

Consumers' willingness and ability to travel to a reservation to purchase cigarettes. A smoker's willingness and ability to travel to a reservation to purchase cigarettes is directly related to the smoker's proximity to a reservation. In 2004, 64 percent of New York smokers who lived within 30 miles of a reservation purchased cigarettes from a tribal store at least once compared with 30 percent of smokers who lived within 31-55 miles from a reservation, and 15 percent of smokers who lived more than 55 miles from a reservation[13]. At that time, tribal stores were selling premium brands without tax, but the per-pack tax was lower, at $1.50 per pack. More recently, when the State tax was its current $4.35 but tribal outlets were still selling untaxed premium brand cigarettes, results from the 2010 Erie-Niagara Tobacco Use Survey[14] showed that 73 percent of smokers surveyed reported purchasing cigarettes from reservation venues at least once within the past year, and 85 percent of those individuals "all of the time" or "sometimes" purchased their cigarettes from reservation venues.

Eight of the eleven reservations in New York State are located in Western and Central New York. Therefore, we can expect a higher share of smokers living in these areas to visit tribal stores to purchase cigarettes.

We assign a tier to all Counties in the State based on their proximity to a reservation. The following criteria were used to create the tier system:

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[12] We use population aged 15 and above as estimates of those aged 18 and above are unavailable for counties. Since we use the county **share relative to the total state population county**, the results are essentially identical to the results of a choice of age18+ population.

[13] *Source*: Davis, Farrelly, Li, and Hyland (2006).

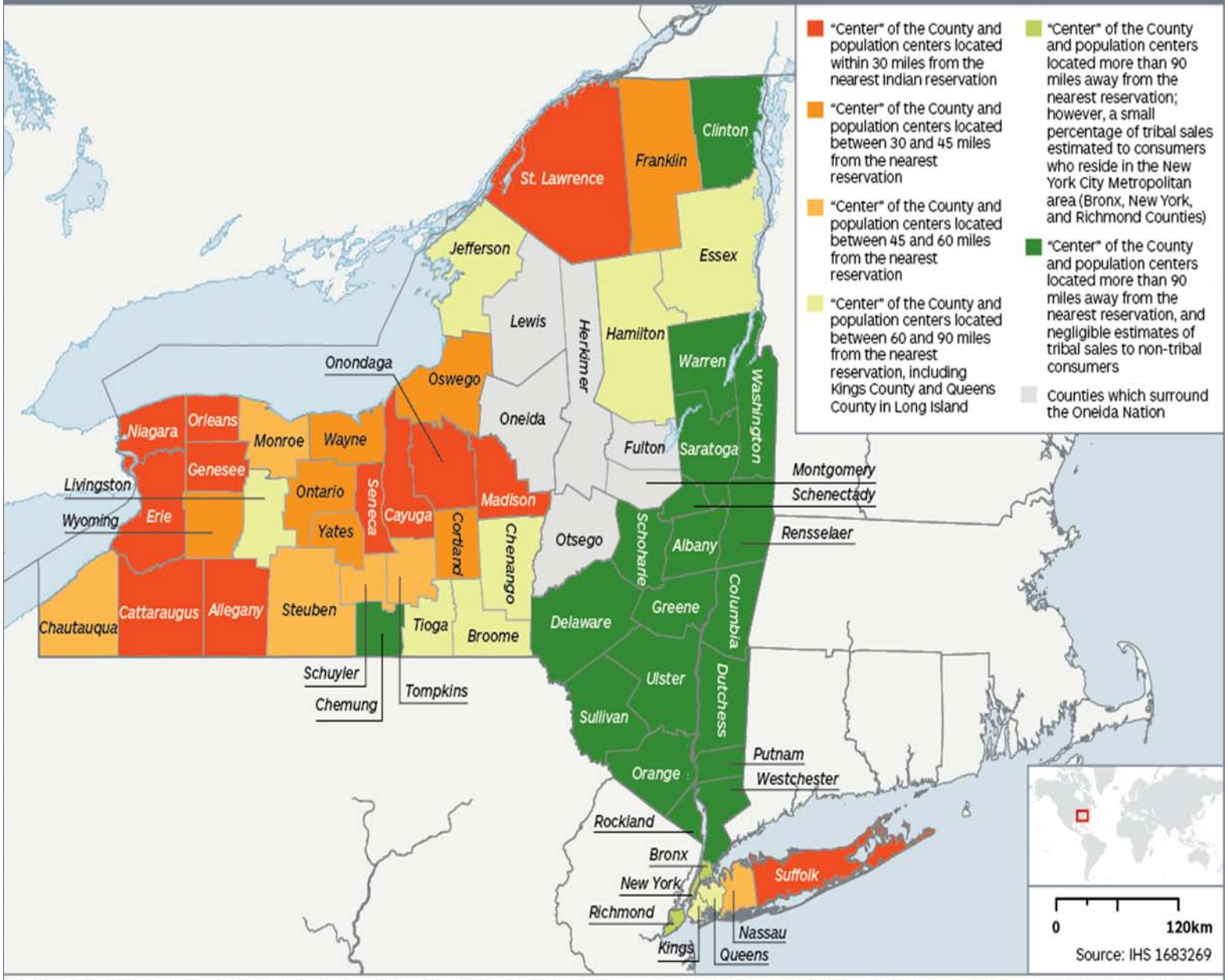
[14] Source: Roswell Park Cancer Institute. Hyland, Smith, Fix, and Rivard (March 2012).

Tier	Criterion
1	"Center"[15] of the County and population centers located within 30 miles from the nearest Indian reservation
2	"Center" of the County and population centers located between 30 and 45 miles from the nearest reservation
3	"Center" of the County and population centers located between 45 and 60 miles from the nearest reservation
4	"Center" of the County and population centers located between 60 and 90 miles from the nearest reservation, including Kings County (Brooklyn) and Queens County in Long Island
5	"Center" of the County and population centers located more than 90 miles away from the nearest reservation; however, a small percentage of tribal sales estimated for consumers who reside in the New York City Metropolitan area (Bronx, New York, and Richmond Counties)[16]
6	"Center" of the County and population centers located more than 90 miles away from the nearest reservation, and negligible estimates of tribal sales to non-tribal consumers

[15] The "center" point of the County as defined by the Google maps algorithm. Factors such as population centers within the Counties and access to major interstates were taken into consideration during the assignment of tiers.

[16] The Bronx, New York, and Richmond Counties were assigned to this separate tier since travelling to the nearest Shinnecock reservation involves crossing bridges, and the additional cost of tolls. This decreases the potential savings received by travelling to purchase cigarettes from tribal retailers.

Cigarette purchases by non-tribal members from tribal retailers in New York State



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Impact of the potential discount received by purchasing cigarettes from tribal stores. The price smokers pay to buy fully-taxed cigarettes within New York State varies little based on their geographical location within the state, other than the price differential in New York City as a result of the additional $1.50 per pack local tax levied on cigarettes sold in New York City.

Smokers who frequently purchase cigarettes from reservations pay significantly lower prices for tribal brand cigarettes than everyday convenience store purchasers pay for fully-taxed cigarettes, including the discount brands of the PMs.

We assume that the New York consumers who live more than 90 miles away from a reservation would likely seek alternative sources, such as retail outlets in neighboring states, to purchase low-tax cigarettes. Also, we note that the reported smuggling of large quantities of low-tax cigarettes into the New York City area involves premium brand PM cigarettes from low-tax states such as Virginia, and does not appear to involve the smuggling of untaxed tribal brand cigarettes from Indian reservations[17].

Consumers' brand loyalty and demand elasticity for cigarettes. Beginning June 2011, wholesale dealers of cigarettes not manufactured by Native Americans (namely, all the national PM premium brands, as well as the "discount" brands made and sold by the manufacturers of the premium brands) were required by New York State to pay for and affix tax stamps on all such cigarette packs shipped to reservations, including cigarettes sold to tribal members for their consumption (for which special provisions allowed such sales to proceed on a tax-free basis). This change put a stop to the sale to the tribes of untaxed cigarettes not manufactured by Native American manufacturers (although we note our recent field observation from April 2016 , cited earlier, that premium brands continue to be sold at some tribal outlets in New York). However, tribal brand cigarettes (also referred to herein as tribal discount brands) produced by or for the tribes do not pass through the State stamping agents, and continue to be sold on reservations without payment of New York State's cigarette tax.

The 2011 change completely halted the legal sale of untaxed premium brand cigarettes to reservation cigarette sellers. Brand loyal consumers were no longer able to purchase those brands tax-free from the tribes when the tribal outlets had sold out their inventories. On the other hand, consumers who view discount brands of cigarettes, including those made by tribal manufacturers, as substitutes for premium brand cigarettes would still have an incentive to purchase from tribal stores. These smokers, as consumers, would respond to the unavailability of tax-free premium brand cigarettes by increasing the demand for discount brand cigarettes, including those made by Native American manufacturers. Thus, a smoker's incentive to purchase from a tribal store depends on the degree of substitutability between these two types of products. In addition, we can expect consumers who are price-sensitive to continue to purchase cigarettes from tribal stores by switching from premium brand cigarettes to tribal discount brands.

Academic studies have found that, on average, a 10 percent increase in the price difference between premium and discount brands results in a 10 percent increase in the sales share of discount brands[18]. IHS Global has estimated the price elasticity of cigarette demand to be approximately -0.33. We can combine these two elasticities to estimate the combined impact on tribal demand of the events of 2010-2011 – the prohibition of tax-free sales of premium cigarettes on the reservations, and the increase in the State excise tax to $4.35 per pack. Assuming these elasticities, we predict that tribal demand would have increased by approximately 25 percent.

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[17] RTI International. Cigarette Trafficking in Five Northeastern Cities (2013).
[18] *Source*: DeCicca, Kenkel, and Liu (2014).

The current consumer choice framework of New York smokers is as follows:

1. Purchase cigarettes from off-reservation retailers and pay the New York State (and New York City tax where applicable)
    a. Major label or premium brand cigarettes
    b. Discount brand cigarettes
2. Purchase cigarettes from off-reservation retailers who avoid paying New York State/City taxes, from out-of-state retailers, or from duty free stores
3. Purchase tribal brand cigarettes from reservation retailers

Model Parameters

We assume that S_N in 2015 was 761 million packs, which is the total (taxed and untaxed) number of cigarette packs we estimate were consumed in New York State in 2015.

β_c represents the fraction of smoker who might visit a tribal shop to purchase cigarettes. From surveys during the 2000s and the Roswell 2006 survey we fix this parameter to be 75 percent for Counties assigned to tier 1. For Counties assigned to tiers 2, 3, 4, 5, and 6 the shares are 37.5 percent, 25 percent, 15 percent, 3.75 percent, and 1.5 percent, respectively. Applying this framework to the estimated number of smokers in each County we closely replicate the survey results on tribal shop visitation. That is, these fractions have been selected by calibrating the resulting distribution of tribal visits to the earlier surveys. The Roswell study reported the following shares of smokers "who purchased at least once from Indian reservations in the past year": 75 percent in the Western region[19], 51 percent in the Central region[20], 28 percent in the Capital region[21], and 16 percent in the New York City Metropolitan region[22].

The 2012 Roswell study found that the popularity of reservation brand cigarettes in Western New York increased from 13.4 percent in 2004, to 24 percent in 2011[23]. This was before tribal outlets lost legal access to untaxed premium brands. In other words, during these time premium brands were available tax-free and closer in price to tribal brands. The biggest price spread came beginning in late 2011. Statistical tests had shown that there was a statistically significant difference between these estimates across the two periods. This change in preference is suggestive of not only the availability of these types of cigarettes in reservation retail outlets, but also that area smokers may be willing to switch from premium brand cigarettes to lower cost brands as a result of price sensitivity in light of higher overall cigarette prices in any cigarette retail venue.

[19] The following Counties were included in the Western region: Allegany, Cattaraugus, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Niagara, Ontario, Orleans, Schuyler, Seneca, Steuben, Wayne, Wyoming, and Yates.
[20] The following Counties were included in the Central region: Broome, Cayuga, Chenango, Cortland, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Oswego, St. Lawrence, Tioga, and Tompkins.
[21] The following Counties were included in the Capital region: Albany, Clinton, Columbia, Delaware, Essex, Franklin, Fulton, Greene, Hamilton, Montgomery, Otsego, Rensselaer, Saratoga, Schenectady, Schoharie, Warren, and Washington.
[22] The following Counties were include in the Metropolitan region: Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester.
[23] *Source*: Roswell Park Cancer Institute. Hyland, Smith, Fix, and Rivard (March 2012).

We assume that Roswell's factor of 24 percent presents a credible estimate of the tribal demand in the presence of nearby tribal shops in 2011, applicable to smokers across the state, assuming that is, that smokers in the rest of New York State have the same proclivity to visit a tribal shop a certain distance away as smokers in the Western region. However, the tribal cigarette market has evolved further since then with untaxed premium brand cigarettes unavailable and proliferation of tribal brands. Therefore, we increase Roswell's 24 percent factor by the 25 percent market share effect described in the prior section to account for the impact of relative price and availability changes since 2011, resulting in a base tribal demand of 30 percent.

Table 4 displays the County-level variables in our calculation and estimated tribal sales to non-tribal consumers for all Counties.

The Oneida Nation, even with the Oneida Nation Tax, continues to sell discounted Indian brand cigarettes. The New York State Department of Tax & Finance reports that in the 12-month period ending November 30, 2015 the Oneida Nation bought from Indian wholesalers approximately 1.94 million packs of Indian brand cigarettes (presumably for resale), compared with 814,940 of premium brands. Therefore, we assume that the Oneida Nation sold 1.94 million packs of cigarettes to consumers in surrounding Counties (Lewis, Herkimer, Otsego, Fulton, and Montgomery Counties) in 2015. Our understanding is that tribal brands sold by the Oneidas sell at a significant discount from premium brands at nearby convenience stores, largely due to the language in the Oneida Agreement, in the section dealing with equal pricing standards for cigarettes, to the effect that "the basic cost of [Indian made cigarettes], for purposes of establishing applicable minimum prices, shall be 60 percent of the average manufacturer's list price, before trade or rebates, of the top three brands by market share."

Table 4

Geography	County population aged 15 and above, 2015 (thousands)	County's share of New York State population	Tier	Share of smokers who visit tribal stores	Tribal sales to non-tribal consumers (millions of packs)
Albany County	261.06	1.60%	6	1.5%	0.055
Allegany County	39.23	0.24%	1	75%	0.411
Bronx County	1,144.68	7.02%	5	3.75%	0.600
Broome County	165.35	1.01%	4	15%	0.347
Cattaraugus County	63.12	0.39%	1	75%	0.662
Cayuga County	65.50	0.40%	1	75%	0.687
Chautauqua County	108.45	0.66%	3	25%	0.379
Chemung County	71.35	0.44%	6	1.5%	0.015
Chenango County	40.50	0.25%	4	15%	0.085
Clinton County	68.99	0.42%	6	1.5%	0.014
Columbia County	52.45	0.32%	6	1.5%	0.011
Cortland County	40.63	0.25%	2	37.5%	0.213
Delaware County	39.15	0.24%	6	1.5%	0.008
Dutchess County	247.97	1.52%	6	1.5%	0.052
Erie County	770.33	4.72%	1	75%	8.081
Essex County	32.83	0.20%	4	15%	0.069
Franklin County	42.27	0.26%	2	37.5%	0.222
Fulton County*	44.41	0.27%	-	-	0.214
Genesee County	48.72	0.30%	1	75%	0.511
Greene County	40.92	0.25%	6	1.5%	0.009
Hamilton County	4.11	0.03%	4	15%	0.009
Herkimer County*	52.06	0.32%	-	-	0.250
Jefferson County	91.70	0.56%	4	15%	0.192
Kings County	2,128.74	13.05%	4	15%	4.466
Lewis County*	21.58	0.13%	-	-	0.104
Livingston County	54.29	0.33%	4	15%	0.114
Madison County	59.97	0.37%	1	75%	0.629
Monroe County	617.50	3.78%	3	25%	2.159
Montgomery County*	40.22	0.25%	-	-	0.193
Nassau County	1,121.09	6.87%	3	25%	3.920
New York County	1,440.60	8.83%	5	3.75%	0.756
Niagara County	177.79	1.09%	1	75%	1.865
Oneida County*[24]	190.98	1.17%	-	-	0.918
Onondaga County	384.00	2.35%	1	75%	4.028
Ontario County	90.97	0.56%	2	37.5%	0.477
Orange County	294.69	1.81%	6	1.5%	0.062
Orleans County	34.78	0.21%	1	75%	0.365
Oswego County	98.47	0.60%	2	37.5%	0.516
Otsego County*	52.22	0.32%	-	-	0.251
Putnam County	82.55	0.51%	6	1.5%	0.017
Queens County	1,949.69	11.95%	4	15%	4.090
Rensselaer County	133.15	0.82%	6	1.5%	0.028
Richmond County	387.92	2.38%	5	3.75%	0.203
Rockland County	249.96	1.53%	6	1.5%	0.052
Saratoga County	186.62	1.14%	6	1.5%	0.039
Schenectady County	127.26	0.78%	6	1.5%	0.027
Schoharie County	26.69	0.16%	6	1.5%	0.006
Schuyler County	15.59	0.10%	3	25%	0.055
Seneca County	28.91	0.18%	1	75%	0.303
St. Lawrence County	90.92	0.56%	1	75%	0.954
Steuben County	79.93	0.49%	3	25%	0.279
Suffolk County	1,234.06	7.56%	1	75%	12.945
Sullivan County	61.88	0.38%	6	1.5%	0.013

[24] Counties surrounding the Oneida Nation for which tribal sales of 1.93 million packs were allocated are indicated with an *

Tioga County	40.43	0.25%	4	15%	0.085
Tompkins County	91.55	0.56%	3	25%	0.320
Ulster County	152.27	0.93%	6	1.5%	0.032
Warren County	54.58	0.33%	6	1.5%	0.011
Washington County	51.88	0.32%	6	1.5%	0.011
Wayne County	74.87	0.46%	2	37.5%	0.393
Westchester County	796.12	4.88%	6	1.5%	0.167
Wyoming County	34.37	0.21%	2	37.5%	0.180
Yates County	20.29	0.12%	2	37.5%	0.106
Total	**16,315.16**				**54.239**

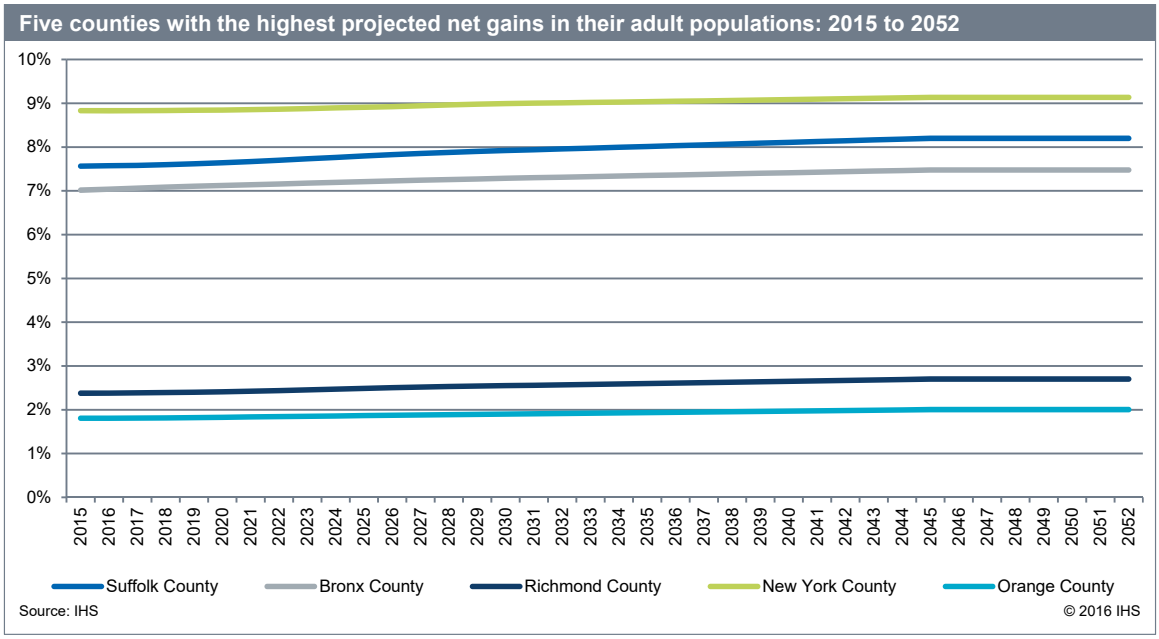
For example, Cattaraugus County in the Western region is assigned to tier 1 since the center of the county and its population centers are located within 30 miles of the Allegany and Oil Springs reservations. Its population (aged 15 and above) in 2015 was approximately 63,000, which was 0.39 percent of the total population in New York State. Assuming that 75 percent of its smokers visit tribal stores regularly to purchase cigarettes, we estimate that 657,000 packs were purchased by non-tribal consumers in 2015. Similarly, Onondaga County is also assigned to tier 1 given the distance from the center of the County and its population centers to the Onondaga reservation. Its population aged 15 and above in 2015 was 384,000, which was 2.4 percent of the New York population. We estimate that approximately 4.0 million packs of cigarettes were tribal purchases by non-tribal consumers. Comparatively, we estimate that tribal purchases in Nassau County were roughly the same volume as Onondaga at 3.9 million packs. Nassau County is assigned to tier 3 given the distance between the center of the County and its population centers to the Poospatuck reservation. Nassau County's population of 1.1 million was approximately 6.9 percent of New York State's adult population in 2015.

Performing this calculation for the rest of the Counties, the state-wide estimate of tribal cigarette sales to non-tribal consumers is 53.8 million packs. Thus, for 2015 we estimate that 761 million packs were consumed in New York in 2015, of which 280 million were taxed by New York State, 427 million were from out-of-state, and 54 million purchased at tribal shops.

Forecasts of Tribal Cigarette Sales to New York Consumers

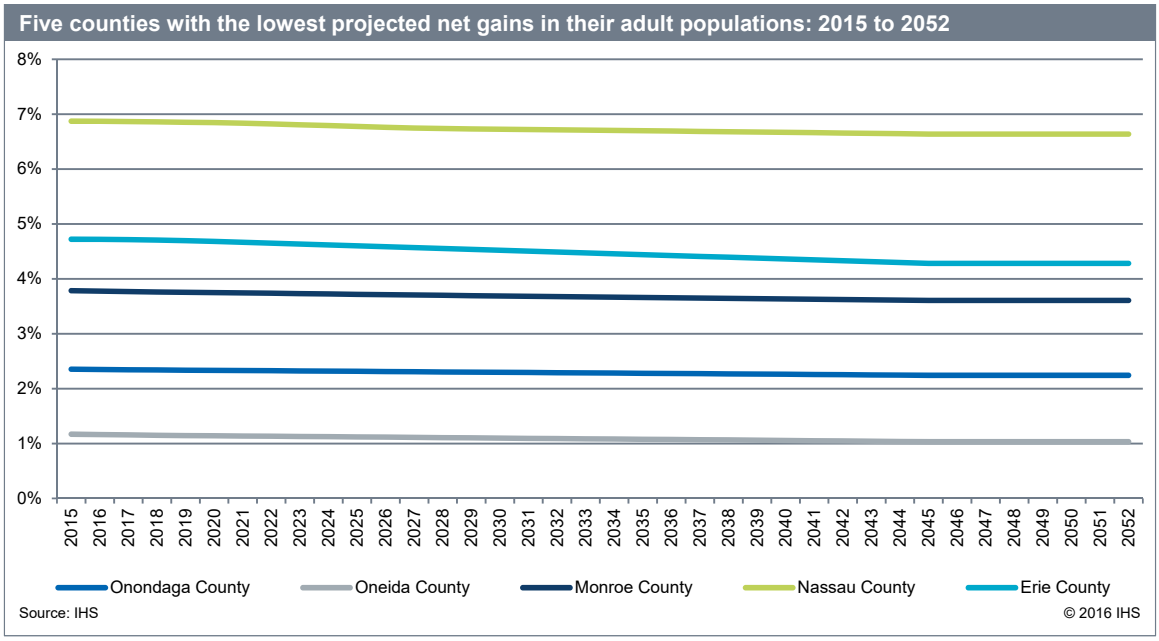
The IHS Global Regional Economic Service forecasts County-level population over the next 37 years. Therefore, we employ the above methodology to project tribal cigarette sales to non-tribal consumers. The County's share of the total population in New York (P_c/P_N) can be calculated using IHS Global's population projections. Current projections indicate that the Suffolk, Bronx, Richmond, New York, and Orange Counties will experience the largest net gains in their adult populations over the next 37 years.

Figure 5



The following Counties are projected to experience the lowest net gains to their adult populations over the next 37 years: Erie, Nassau, Monroe, Oneida, and Onondaga.

Figure 6



We also need a forecast of total, taxed and untaxed, cigarette sales in New York State (S_N). Recall that total cigarette sales were estimated to be 761 million packs in 2015. IHS Global has calculated a 40-year projection of total cigarette sales for the United States. We expect that U.S. sales will decline at an average rate of 3.0 percent over the next 40 years. One can reasonably assume that New York's total sales will also decline at a similar rate. However, the decline in New York is likely to be slightly faster given its slower population growth compared to the rest of the country. Over the next 37 years, the total U.S. adult population (aged 15 and above) is projected to grow at an average rate of 0.68 percent, while the same rate for New York is 0.03 percent. In order to account for this difference, we subtract the difference in the growth rates from the projected growth of total cigarette sales. The resulting forecast of total taxed and untaxed cigarette sales in New York declines at an average rate of 3.6 percent over the forecast period. This translates to a decline of 75 percent over the next 37 years to 194 million packs in 2052. An important and implicit assumption in this projection is that the share of cross-border cigarette sales remains constant over the forecast period.

Table 5 displays projections of total – taxed and untaxed – cigarette sales in New York State.

Table 5

Year	Projected growth in U.S. cigarette sales	Projected growth differential between U.S. and New York populations, aged 15 and above	Projected growth in total taxed and untaxed cigarette sales in New York	Projected total taxed and untaxed cigarette sales in New York (millions of packs)
2015	…	…	…	761
2016	-3.5%	-0.6%	-4.1%	729
2017	-3.6%	-0.6%	-4.2%	699
2018	-3.6%	-0.6%	-4.2%	669
2019	-3.5%	-0.6%	-4.1%	642
2020	-3.4%	-0.6%	-4.0%	616
2021	-3.3%	-0.6%	-3.9%	592
2022	-3.1%	-0.6%	-3.8%	570
2023	-3.0%	-0.6%	-3.7%	549
2024	-2.9%	-0.6%	-3.5%	530
2025	-2.8%	-0.6%	-3.4%	512
2026	-2.7%	-0.6%	-3.3%	495
2027	-2.7%	-0.6%	-3.3%	478
2028	-2.7%	-0.6%	-3.3%	462
2029	-2.7%	-0.6%	-3.3%	447
2030	-2.7%	-0.7%	-3.3%	432
2031	-2.7%	-0.7%	-3.3%	418
2032	-2.7%	-0.7%	-3.3%	404
2033	-2.7%	-0.7%	-3.4%	390
2034	-2.8%	-0.7%	-3.4%	377
2035	-2.8%	-0.7%	-3.4%	364
2036	-2.8%	-0.7%	-3.5%	351
2037	-2.8%	-0.7%	-3.5%	339
2038	-2.8%	-0.7%	-3.5%	327
2039	-2.9%	-0.7%	-3.6%	315
2040	-2.9%	-0.7%	-3.6%	304
2041	-2.9%	-0.7%	-3.6%	293
2042	-2.9%	-0.7%	-3.6%	283
2043	-3.0%	-0.7%	-3.6%	272
2044	-3.0%	-0.7%	-3.7%	262
2045	-3.0%	-0.7%	-3.7%	253
2046	-3.0%	-0.7%	-3.7%	243
2047	-3.0%	-0.7%	-3.7%	234
2048	-3.0%	-0.7%	-3.7%	226
2049	-3.0%	-0.7%	-3.7%	217
2050	-3.0%	-0.7%	-3.7%	209
2051	-3.0%	-0.7%	-3.7%	201
2052	-3.0%	-0.7%	-3.7%	194

We assume that the share of smokers who visit tribal stores regularly to purchase cigarettes (β_c) remains constant in each tier, over the forecast period. For Counties assigned to tier 1 this share would be 75 percent; shares for tiers 2, 3, 4, 5, and 6 would be 37.5 percent, 25 percent, 15 percent, 3.75 percent, and 1.5 percent, respectively.

In our baseline forecast, we assume that the impact on demand for tribal discount cigarettes based on the price differential received by non-tribal consumers (D_c) remains constant at 30 percent over the forecast period.

When forecasting estimates of tribal cigarette sales to non-tribal consumers, it is important to note the increasing effectiveness of authorities in enforcing the federal PACT Act and the Racketeer Influenced and Corrupt Organizations (RICO) Act in recent years. The Postal Service is barred from shipping cigarettes, and the State has separate agreements with FedEx and UPS to discontinue the practice of shipping cigarettes.

However, there have been numerous instances where these shipping companies and others have flouted the law. For example, in 2014, New York State commenced a $235 million lawsuit against FedEx accusing the company of shipping 400,000 cartons of untaxed cigarettes to consumers across New York State in violation of their 2006 agreement and in direct violation of the PACT Act. This was on top of a 2013 lawsuit where New York City sued the company for $52 million for shipping 55,000 cartons of untaxed cigarettes to its residents[25]. A 2014 *New York Daily News* article noted that millions of these cigarettes came from the Shinnecock Smoke Shop on the Shinnecock reservation on Long Island[26]. The Southampton-based store had been sued numerous times for selling untaxed cigarettes.

In 2015, New York State and New York City accused UPS of having since 2010 illegally shipped 683,000 unstamped cartons of cigarettes to unlicensed wholesalers, unlicensed retailers, and residences, often from smoke shops on Native American reservations within New York[27].

In addition, a 2013 *New York Post* article reported that some reservation-based distributors had turned to new networks of logistics and shipping companies to reach consumers[28]. In November 2013, the City of New York had taken the unusual step of suing a Virginia-based delivery company that had helped the reservation shops deliver cigarettes into the city without charging consumers the required tax of $5.85 per pack. The City sought $80.6 million in damages and penalties.

One can likely expect that these lawsuits may deter some reservation smoke shops from shipping untaxed cigarettes to consumers and otherwise evading excise tax payments. Therefore, we adjust our forecasts over the next five years—between 2016 and 2020—to account for the increasing effectiveness of law enforcement. A few of the high-profile lawsuits mentioned above sued FedEx and UPS for transporting an average of 2.2 million packs per year between 2010 and 2013. Therefore, we introduce an adjustment factor to the forecast which projects that State enforcement is able to gradually reduce tribal sales by 2 to 4 million packs over the 2016-20 period.

The estimate of tribal cigarette sales to non-tribal consumers in 2015 was 54.2 million packs. Performing the above calculation for the rest of the Counties, we estimate tribal purchases of cigarettes to decline by 75 percent over the forecast period, to 13.5 million packs in 2052. In the case of Oneida County and others which surround the Oneida Nation (Lewis, Herkimer, Otsego, Fulton, and Montgomery Counties), we assume that tribal sales of 1.93 million packs in 2015 will decelerate at the same rate of growth as total packs (taxed and untaxed) in New York (see Table 5), over the forecast interval.

Table 6 displays estimates of total tribal cigarette purchases by non-tribal consumers over the forecast period.

[25] *Source*: New York Post, December 31, 2013.
[26] *Source*: New York Daily News, March 30, 2014.
[27] *Source*: Reuters, September 16, 2015.
[28] *Source*: New York Post, December 2, 2013.

Table 6

Year	Tribal sales to non-tribal consumers (millions of packs)	Growth
2015	54.239	…
2016	49.809	-8.2%
2017	47.123	-5.4%
2018	44.543	-5.5%
2019	42.083	-5.5%
2020	39.761	-5.5%
2021	38.257	-3.8%
2022	36.862	-3.6%
2023	35.565	-3.5%
2024	34.362	-3.4%
2025	33.236	-3.3%
2026	32.170	-3.2%
2027	31.149	-3.2%
2028	30.160	-3.2%
2029	29.198	-3.2%
2030	28.266	-3.2%
2031	27.364	-3.2%
2032	26.492	-3.2%
2033	25.632	-3.2%
2034	24.798	-3.3%
2035	23.992	-3.3%
2036	23.208	-3.3%
2037	22.448	-3.3%
2038	21.709	-3.3%
2039	20.985	-3.3%
2040	20.282	-3.4%
2041	19.607	-3.3%
2042	18.950	-3.4%
2043	18.311	-3.4%
2044	17.691	-3.4%
2045	17.091	-3.4%
2046	16.523	-3.3%
2047	15.974	-3.3%
2048	15.445	-3.3%
2049	14.935	-3.3%
2050	14.444	-3.3%
2051	13.969	-3.3%
2052	13.512	-3.3%

Figure 7

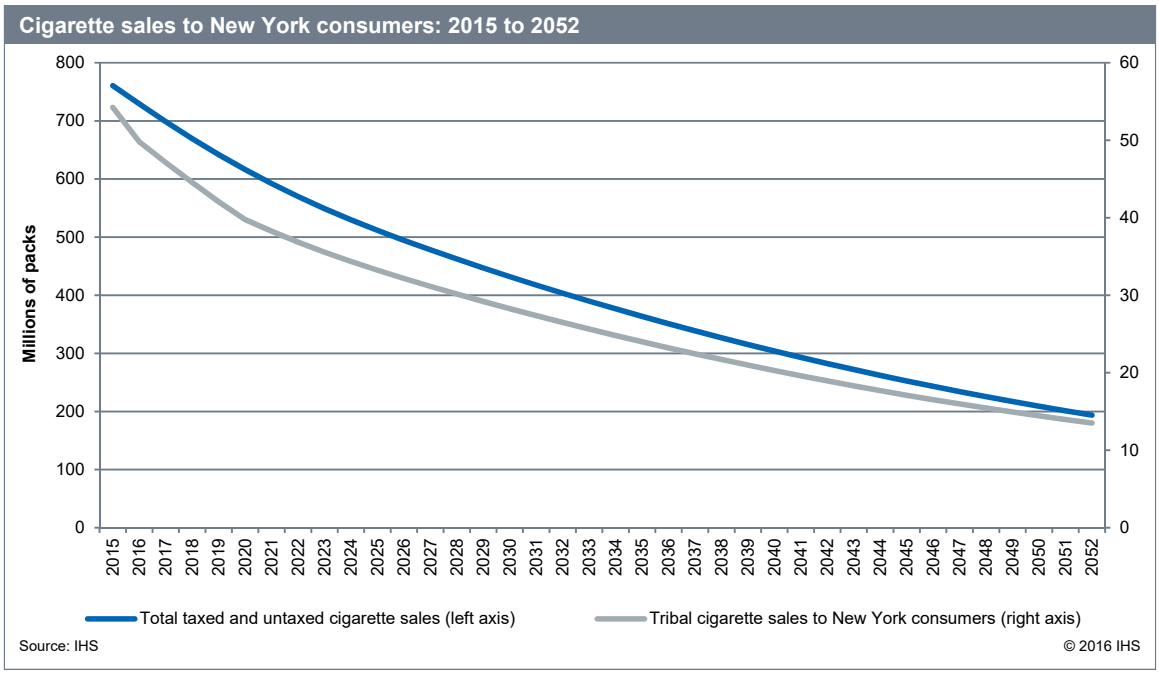


Table 7 displays tribal cigarette purchases by non-tribal consumers for all Counties during select years in the forecast period.

Table 7

Geography	2015	2020	2025	2030	2035	2040	2045	2052
Albany County	0.055	0.040	0.032	0.027	0.023	0.019	0.016	0.012
Allegany County	0.411	0.292	0.237	0.195	0.161	0.132	0.108	0.083
Bronx County	0.600	0.445	0.374	0.319	0.271	0.228	0.191	0.147
Broome County	0.347	0.248	0.203	0.168	0.140	0.115	0.094	0.072
Cattaraugus County	0.662	0.465	0.371	0.302	0.247	0.201	0.162	0.124
Cayuga County	0.687	0.494	0.403	0.334	0.276	0.227	0.185	0.142
Chautauqua County	0.379	0.269	0.216	0.177	0.144	0.117	0.095	0.073
Chemung County	0.015	0.011	0.009	0.007	0.006	0.005	0.004	0.003
Chenango County	0.085	0.061	0.050	0.042	0.035	0.029	0.024	0.018
Clinton County	0.014	0.011	0.009	0.007	0.006	0.005	0.004	0.003
Columbia County	0.011	0.008	0.007	0.005	0.005	0.004	0.003	0.002
Cortland County	0.213	0.153	0.127	0.107	0.089	0.074	0.061	0.047
Delaware County	0.008	0.006	0.005	0.004	0.003	0.003	0.002	0.002
Dutchess County	0.052	0.038	0.032	0.028	0.024	0.020	0.017	0.013
Erie County	8.081	5.844	4.768	3.956	3.270	2.685	2.190	1.680
Essex County	0.069	0.049	0.041	0.034	0.029	0.024	0.020	0.015
Franklin County	0.222	0.159	0.130	0.107	0.089	0.073	0.059	0.045
Fulton County	0.214	0.189	0.192	0.194	0.195	0.196	0.198	0.198
Genesee County	0.511	0.364	0.297	0.247	0.205	0.169	0.138	0.106
Greene County	0.009	0.006	0.005	0.005	0.004	0.003	0.003	0.002
Hamilton County	0.009	0.006	0.005	0.004	0.003	0.003	0.002	0.002
Herkimer County	0.250	0.220	0.220	0.221	0.221	0.220	0.220	0.220
Jefferson County	0.192	0.135	0.110	0.090	0.074	0.061	0.049	0.038
Kings County	4.466	3.277	2.712	2.286	1.924	1.608	1.336	1.025
Lewis County	0.104	0.092	0.091	0.091	0.091	0.090	0.089	0.089
Livingston County	0.114	0.082	0.067	0.057	0.047	0.039	0.033	0.025
Madison County	0.629	0.455	0.381	0.325	0.274	0.229	0.190	0.146
Monroe County	2.159	1.560	1.284	1.075	0.898	0.746	0.615	0.472
Montgomery County	0.193	0.172	0.173	0.173	0.174	0.174	0.174	0.174
Nassau County	3.920	2.848	2.340	1.961	1.644	1.368	1.131	0.868
New York County	0.756	0.552	0.462	0.393	0.333	0.280	0.234	0.179
Niagara County	1.865	1.344	1.106	0.925	0.768	0.633	0.518	0.398
Oneida County	0.918	0.809	0.808	0.805	0.801	0.798	0.794	0.794
Onondaga County	4.028	2.912	2.399	2.010	1.679	1.392	1.147	0.880
Ontario County	0.477	0.352	0.299	0.257	0.218	0.183	0.153	0.118
Orange County	0.062	0.046	0.039	0.033	0.029	0.024	0.020	0.016
Orleans County	0.365	0.258	0.211	0.176	0.147	0.121	0.100	0.077
Oswego County	0.516	0.367	0.300	0.250	0.207	0.171	0.141	0.108
Otsego County	0.251	0.224	0.228	0.230	0.231	0.233	0.235	0.235
Putnam County	0.017	0.013	0.011	0.009	0.008	0.007	0.006	0.004
Queens County	4.090	2.994	2.472	2.078	1.748	1.461	1.214	0.931
Rensselaer County	0.028	0.020	0.017	0.014	0.012	0.010	0.008	0.006
Richmond County	0.203	0.150	0.129	0.112	0.096	0.082	0.069	0.053
Rockland County	0.052	0.039	0.032	0.028	0.023	0.020	0.016	0.012
Saratoga County	0.039	0.029	0.025	0.021	0.018	0.015	0.013	0.010
Schenectady County	0.027	0.019	0.016	0.013	0.011	0.009	0.008	0.006
Schoharie County	0.006	0.004	0.003	0.003	0.002	0.002	0.002	0.001
Schuyler County	0.055	0.039	0.032	0.026	0.022	0.018	0.015	0.011
Seneca County	0.303	0.220	0.184	0.154	0.129	0.107	0.088	0.068
St. Lawrence County	0.954	0.679	0.552	0.457	0.378	0.309	0.251	0.193
Steuben County	0.279	0.201	0.164	0.136	0.113	0.093	0.076	0.059
Suffolk County	12.945	9.540	8.076	6.931	5.900	4.990	4.193	3.217
Sullivan County	0.013	0.009	0.008	0.007	0.006	0.005	0.004	0.003
Tioga County	0.085	0.060	0.049	0.041	0.034	0.028	0.023	0.017
Tompkins County	0.320	0.234	0.194	0.164	0.139	0.116	0.097	0.074
Ulster County	0.032	0.023	0.019	0.016	0.014	0.011	0.009	0.007
Warren County	0.011	0.008	0.007	0.006	0.005	0.004	0.003	0.003
Washington County	0.011	0.008	0.007	0.006	0.005	0.004	0.003	0.003

Wayne County	0.393	0.280	0.230	0.192	0.160	0.133	0.109	0.084
Westchester County	0.167	0.122	0.101	0.085	0.072	0.060	0.050	0.038
Wyoming County	0.180	0.128	0.104	0.086	0.071	0.058	0.047	0.036
Yates County	0.106	0.077	0.064	0.054	0.045	0.038	0.031	0.024
Total	**54.239**	**39.761**	**33.236**	**28.266**	**23.992**	**20.282**	**17.091**	**13.512**

Alternative Scenarios

We explore an alternate scenario by allowing for a lower impact on the demand for tribal brand cigarettes based on the price differential received by non-tribal consumers (D_c). Instead of the 30 percent used in our baseline forecast, we use the rate of 24 percent reported by the Roswell 2012 study. Holding all else constant, estimates of tribal sales to non-tribal consumers decrease by 20 to 25 percent over the forecast period.

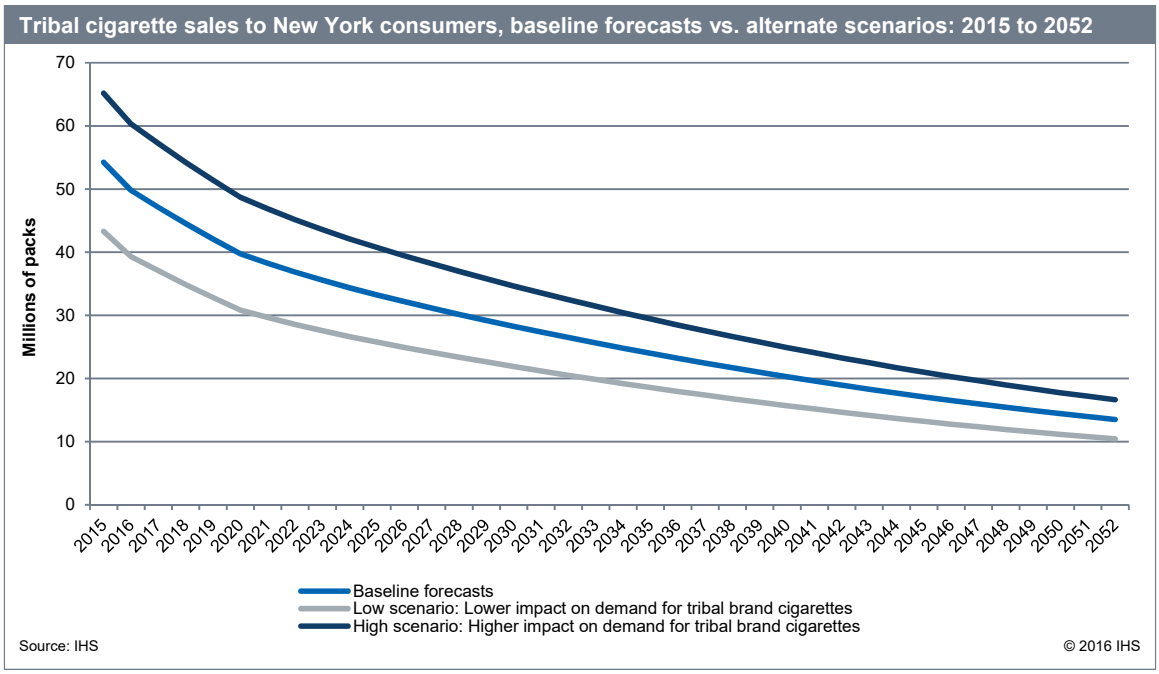
Similarly, we allow for a higher impact on the demand for tribal brand cigarettes based on the price differential received by non-tribal consumers (D_c). We increase the parameter of 30 percent to 36 percent based on estimates of the confidence interval for the demand elasticity of cigarettes. Holding all else constant, estimates of tribal sales to non-tribal consumers increase by 20 to 25 percent over the forecast period.

Projections of tribal cigarette sales to non-tribal consumers in both scenarios are shown in Table 8.

Table 8

Year	High Scenario		Low Scenario	
	Tribal sales to non-tribal consumers (millions of packs)	Growth	Tribal sales to non-tribal consumers (millions of packs)	Growth
2015	65.183	…	43.294	…
2016	60.315	-7.5%	39.302	-9.2%
2017	57.239	-5.1%	37.079	-5.7%
2018	54.218	-5.3%	34.869	-6.0%
2019	51.410	-5.2%	32.825	-5.9%
2020	48.700	-5.3%	30.823	-6.1%
2021	46.890	-3.7%	29.682	-3.7%
2022	45.155	-3.7%	28.569	-3.7%
2023	43.597	-3.5%	27.587	-3.4%
2024	42.099	-3.4%	26.626	-3.5%
2025	40.747	-3.2%	25.775	-3.2%
2026	39.418	-3.3%	24.922	-3.3%
2027	38.195	-3.1%	24.151	-3.1%
2028	36.961	-3.2%	23.359	-3.3%
2029	35.810	-3.1%	22.635	-3.1%
2030	34.647	-3.3%	21.887	-3.3%
2031	33.568	-3.1%	21.209	-3.1%
2032	32.478	-3.2%	20.508	-3.3%
2033	31.452	-3.2%	19.863	-3.1%
2034	30.407	-3.3%	19.191	-3.4%
2035	29.448	-3.2%	18.588	-3.1%
2036	28.464	-3.3%	17.954	-3.4%
2037	27.560	-3.2%	17.388	-3.2%
2038	26.632	-3.4%	16.789	-3.4%
2039	25.773	-3.2%	16.251	-3.2%
2040	24.887	-3.4%	15.679	-3.5%
2041	24.089	-3.2%	15.180	-3.2%
2042	23.258	-3.4%	14.643	-3.5%
2043	22.504	-3.2%	14.172	-3.2%
2044	21.720	-3.5%	13.665	-3.6%
2045	21.014	-3.2%	13.225	-3.2%
2046	20.292	-3.4%	12.756	-3.5%
2047	19.649	-3.2%	12.356	-3.1%
2048	18.975	-3.4%	11.919	-3.5%
2049	18.379	-3.1%	11.548	-3.1%
2050	17.750	-3.4%	11.140	-3.5%
2051	17.198	-3.1%	10.798	-3.1%
2052	16.639	-3.2%	10.442	-3.3%

Figure 8


Tribal cigarette sales to New York consumers, baseline forecasts vs. alternate scenarios: 2015 to 2052
Millions of packs
70
60
50
40
30
20
10
0
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
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2051
2052
Baseline forecasts
Low scenario: Lower impact on demand for tribal brand cigarettes
High scenario: Higher impact on demand for tribal brand cigarettes
Source: IHS
© 2016 IHS

Conclusion

Since 2000, the prevalence of cigarette smoking among adult New Yorkers declined by 26 percent. At the same time however, taxable cigarette sales as reported by the New York State Department of Tax and Finance have declined by a much larger amount, 73 percent. It has been widely reported that a very large percentage of cigarettes consumed in New York State have evaded State excise taxation. The likely cause is that New York State currently has one of the highest cigarette excise tax rates in the country at $4.35 per pack, and an additional $1.50 per pack levied in New York City.

A large amount of inbound smuggling are likely purchases of cigarettes in other states with lower excise taxes, but up until early 2011, smokers were also able to completely avoid paying the New York State excise tax by purchasing cigarettes online, or by visiting smoke shops located on Indian reservations in the State. The purpose of this report was to estimate the volume of tribal cigarettes sold by reservation retailers in on-premise sales to New York consumers.

To do this we estimate, the total, taxed and untaxed, consumption of cigarettes in each County in New York State. We then estimate, based on the proximity to tribal shops, the propensity of smokers in each County to purchase a tribal brand at a tribal shop. The result is an estimate of 54.2 million packs sold by reservation retailers to non-tribal consumers in 2015.

Using IHS Global's County population, and cigarette consumption projections, we forecast that tribal cigarette sales to non-tribal consumers will fall by 75 percent to 13.5 million packs by 2052. Total taxed and untaxed sales of cigarettes in New York State are projected to be 194 million packs by 2052.

We also present two alternative—one high and one low—scenarios where cigarette sales could have been as high as 65.2 million packs, or as low as 43.3 million packs in 2015. In these alternate scenarios, we vary the impact on the demand for tribal brand cigarettes based on the price differential received by non-tribal consumers.

Appendix

Table A.1: State Cigarette Excise Tax Rates (FY 2016)

State	2016 Tax Rate ($ per pack)	Rank
Alabama	0.675	39
Alaska	2.00	12
Arizona	2.00	12
Arkansas	1.15	32
California	0.87	35
Colorado	0.84	37
Connecticut	3.65	3
Delaware	1.60	23
District of Columbia	2.50	11
Florida	1.339	29
Georgia	0.37	49
Hawaii	3.20	5
Idaho	0.57	44
Illinois	1.98	17
Indiana	0.995	34
Iowa	1.36	28
Kansas	1.29	31
Kentucky	0.60	42
Louisiana	0.86	36
Maine	2.00	12
Maryland	2.00	12
Massachusetts	3.51	4
Michigan	2.00	12
Minnesota	3.00	8
Mississippi	0.68	38
Missouri	0.17	51
Montana	1.70	20
Nebraska	0.64	40
Nevada	1.80	18
New Hampshire	1.78	19
New Jersey	2.70	9
New Mexico	1.66	22
New York	4.35	1
North Carolina	0.45	47
North Dakota	0.44	48
Ohio	1.60	23
Oklahoma	1.03	33
Oregon	1.32	30
Pennsylvania	1.60	23
Rhode Island	3.75	2
South Carolina	0.57	44
South Dakota	1.53	26
Tennessee	0.62	41
Texas	1.41	27
Utah	1.70	20
Vermont	3.08	6
Virginia	0.30	50
Washington	3.025	7
West Virginia	0.55	46
Wisconsin	2.52	10
Wyoming	0.60	42

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

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MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

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

I. RECITALS

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

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

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

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

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

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

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

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

II. DEFINITIONS

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) the use of comically exaggerated features;

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

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

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

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

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

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

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

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

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

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

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

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing

outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or 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 [XXXXXXXXXXXX],
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

NEW YORK CONSENT DECREE

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CONSENT DECREE

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

PRESENT:

HON. STEPHEN G. CRANE, Justice

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

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

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

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

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

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

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

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

I. JURISDICTION AND VENUE

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

II. DEFINITIONS

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

III. APPLICABILITY

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

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of New York or a Released Party. The State of New York may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment. Provided, however, that a County or Counties may enforce the payment rights provided in Article V of this Consent Decree and Final Judgment, but only against other Counties or the State. Only the State may enforce the provisions of Article V against the Participating Manufacturers.

IV. VOLUNTARY ACT OF THE PARTIES

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

V. MONETARY RELIEF

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

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

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

D. Each County (as defined in this Consent Decree and Final Judgment) further covenants and agrees that it shall not after the occurrence of State-Specific Finality in the State of New York sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

E. Upon the occurrence of State-Specific Finality in the State of New York, the City of New York (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of the action entitled *City of New York et al. v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of New York, Index No. 406225/96, and the County of Erie (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of its action entitled *County of Erie v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of Erie, Index No. 1997/359.

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

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

VI. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

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

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

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

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

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

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

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any

package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

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

VII. MISCELLANEOUS PROVISIONS

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

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

asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

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

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

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

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

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

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

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

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

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

VIII. FINAL DISPOSITION

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

B. The Court finds that the persons signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of New York and the Counties.

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this 23rd day of December, 1998

/s/ SGC
J.S.C.

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

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

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

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

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

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

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

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

PRESENT: HON. STEPHEN G. CRANE, *Justice* — Part 56

THE STATE OF NEW YORK, et al.,

Plaintiff,

- v -

PHILIP MORRIS, INC., et al.,

Defendants.

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

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

	PAPERS NUMBERED
Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____	_____
Answering Affidavits — Exhibits _____	_____
Replying Affidavits _____	_____

Cross-Motion: [ ] Yes [X] No

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

Accordingly, it is

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

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

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

The foregoing constitutes the decision and order of the court.

Dated: April 14, 1999

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

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

APPENDIX D

NY NPM SETTLEMENT

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FINAL

SETTLEMENT AGREEMENT

This Settlement Agreement ("Agreement") is made by and among the undersigned Participating Manufacturers and the State of New York ("New York") to settle and resolve current and potential future claims as provided below on the terms and conditions provided below. In consideration for the payments and credits provided for in this Agreement, and such other consideration as described in this Agreement, the PMs and New York, acting by and through their authorized representatives, memorialize and agree as follows:

I. Definitions

A. All capitalized terms not otherwise defined in this Agreement shall be defined as in the MSA.

B. "[Year] NPM Adjustment," or "NPM Adjustment for [Year]" means the Non-Participating Manufacturer Adjustment ("NPM Adjustment") based on the Market Share Loss for the specified year and applicable to the payments due pursuant to MSA Section IX(c) on April 15 of the year following the specified year, calculated as provided in the MSA. For example, the 2003 NPM Adjustment, or the NPM Adjustment for 2003, means the NPM Adjustment based on the Market Share Loss for 2003 and applicable to the MSA payments due on April 15, 2004.

C. "Allocable Share" means the percentage for the Settling State in question as set forth in Exhibit A to the MSA, except that, as applied to payments under Section IX(c)(2) of the MSA or to the portion of the NPM Adjustment applicable to such payments, it means the percentage for the Settling State in question as determined in 1999 pursuant to Exhibit U of the MSA.

D. "Claims" means any and all claims, demands, actions, suits, proceedings, causes of action, losses, damages, fines, penalties, costs, expenses, fees and liabilities of any nature, whether known or unknown, whether suspected or unsuspected, whether accrued or unaccrued, and whether legal, equitable or statutory.

E. "Complementary Legislation" means either (i) Tax Law §§ 480-b through 480-c in their form as of the Effective Date or (ii) a New York statute substantially in the form of the Model Complementary Legislation proposed by the National Association of Attorneys General in December of 2002.

F. "Effective Date" means the date of execution of this Agreement.

G. "Escrow Statute" means Public Health Law §§ 1399-nn through 1399-pp in their form as of the Effective Date (including the amendment to the Escrow Statute enacted at Laws 2003, ch. 666, approved October 15, 2003 (such amendment being "Allocable Share Repeal")).

H. "New York consumer" means a person as to whom the sale of the Cigarettes at issue is within New York's cigarette excise taxing authority under federal law (whether or not New York imposes or collects an excise tax on those Cigarettes).

I. "New York Excise Tax" means the cigarette excise tax of the State of New York. In the event that the excise tax is revised to set different levels of tax for different Cigarettes, "New York Excise Tax" refers to the highest such level applicable to any PM Cigarettes. New York Excise Tax is not considered "collected" if it is collected but then refunded, in whole or in part.

J. "NPM" means a Non-Participating Manufacturer.

K. "NPM Cigarettes" means Cigarettes (i) of an NPM or (ii) that are treated as Cigarettes of an NPM under Section XVIII(w)(2) of the MSA. Cigarettes are considered to be of an NPM under clause (i) unless they are of a brand that a Participating Manufacturer both listed as its brand for the entire relevant year pursuant to Complementary Legislation and does not dispute is its brand for purposes of calculating its MSA payments for that year.

L. "Parties" means each of the individual PMs and New York (each, a "Party").

M. "PM" means a Participating Manufacturer that is a signatory to this Agreement. "PM" includes the successor(s) of a PM. "OPM" means a PM that is an Original Participating Manufacturer. "SPM" means a PM that is a Subsequent Participating Manufacturer. An SPM that owns a brand formerly owned by an OPM shall be treated for purposes of this Agreement as an OPM with respect to that brand for a year if it would be treated as an OPM with respect to that brand for that year under the MSA for purposes of the NPM Adjustment.

N. "Potential Maximum NPM Adjustment" for the OPMs for a year means the OPMs' total aggregate amount of the NPM Adjustment for such year calculated pursuant to MSA Section IX(d) (without regard to any subsequent revisions to such formula or reduction in such amount pursuant to any agreement between the PMs and any States), assuming that all Settling States' Allocated Payments are subject to the NPM Adjustment for that year and the NPM Adjustment for that year would be applied pursuant to MSA Section IX(d)(1)(C)-(D). An SPM's "Potential Maximum NPM Adjustment" for a year in question means the SPM's total amount of the NPM Adjustment for such year calculated pursuant to MSA Section IX(d) (without regard to any subsequent revisions to such formula or reduction in such amount pursuant to any agreement between the PMs and any States), assuming that all Settling States' Allocated Payments are subject to the NPM Adjustment for that year and the NPM Adjustment for that year would be applied pursuant to MSA Section IX(d)(1)(C)-(D) and (4). In the case of an SPM that owns a brand formerly owned by an OPM, the SPM's "Potential Maximum NPM Adjustment" for purposes of calculations of credits it is to receive under this Agreement as an SPM shall be calculated based solely on (i) the brand or brands it owns that were not formerly owned by an OPM and (ii) any brands it owns that are listed in Exhibit R of the MSA (except for any such brands with respect to which it has assumed the obligations of an OPM).

O. "Tribal NPM Cigarette" means an NPM Cigarette (i) that is sold, shipped or distributed directly or indirectly on or through Native American reservations located in New York, including where the Cigarette is sold, shipped, distributed or routed through such a reservation for sale to consumers elsewhere, (ii) that is manufactured, sold, shipped or distributed by a person or entity having or claiming status as, ownership by, membership in or other affiliation with a New York Native American tribe or one or more members thereof, or (iii) having any other association with a New York Native American tribe or New York Native American reservation that forms any part of the reason why New York did not collect New York Excise Tax on the Cigarette. A Native American reservation located in New York includes any area within the geographic boundaries of the State of New York that is recognized as a tribal reservation, tribal land, qualified reservation, Indian country or Indian trust land by federal law, New York law or both. A New York Native American tribe includes Cayuga Nation, Oneida Nation of New York, Onondaga Nation, Poospatuck or Unkechauge Nation, Saint Regis Mohawk Tribe, Seneca Nation of Indians, Shinnecock Indian Nation, Tonowanda Band of Seneca, Tuscarora Nation and any other tribe or Indian nation that has a Native American reservation located in New York or that is recognized as a Native American tribe or Indian nation located in New York by federal law, New York law or both.

II. The Disputed Payments Account ("DPA")

A. Release of Amounts Attributable to the 2004-2014 NPM Adjustments Held in the DPA as of the Effective Date.

1. The PMs and New York shall jointly instruct the Independent Auditor to determine the amounts currently held in the DPA that were deposited by the PMs and are attributable to any of the 2004-2014 NPM Adjustments.

2. Following the Independent Auditor's confirmation that it will apply the settlement credits as provided in Section III below, the PMs and New York shall jointly instruct the Independent Auditor to release from the DPA to New York an amount equal to New York's proportionate share of the total amount described in paragraph 1, plus the accumulated earnings on the amount released as of the time of release. Nothing in this Agreement shall require or prevent the release from the DPA of any other Settling States' proportionate shares of such amount.

3. With respect to amounts currently held in the DPA that were deposited by the OPMs, the OPMs and New York estimate that the total amount to be released to New York pursuant to paragraph 2 is $671,258,518.13, plus the accumulated earnings thereon. That amount is subject to verification by the Independent Auditor. With respect to amounts currently held in the DPA that were deposited by SPMs, the SPMs and New York estimate that the amount to be released to New York pursuant to paragraph 2 by individual SPMs is the amount listed for that SPM in Appendix A plus the accumulated earnings on each respective amount. The amounts listed in Appendix A are subject to verification by the Independent Auditor. Appendix B addresses the treatment of amounts withheld by Farmers Tobacco Company of Cynthiana, Inc. ("Farmers"), Liggett Group LLC ("Liggett") and Vector Tobacco Inc. ("Vector Tobacco").

B. NPM Adjustment Amounts Not in the DPA as of the Effective Date.

1. NPM Adjustment amounts that are not yet in the DPA, specifically, the 2013-2014 NPM Adjustments for the OPMs and SPMs Tabacalera del Este, S.A. ("TABESA") and U.S. Flue Cured Tobacco Growers, Inc. ("U.S. Flue-Cured") and the NPM Adjustments for subsequent years for all PMs, shall be addressed as provided in this subsection B.

2. In connection with the MSA payment due on April 15 of each year beginning with 2016, the OPMs shall deposit into the DPA New York's Allocable Share of the OPMs' Potential Maximum NPM Adjustment for the year preceding the year of payment by three years. For example, on April 15, 2016, the OPMs shall deposit New York's Allocable Share of the OPMs' Potential Maximum NPM Adjustment for 2013. Each OPM shall be responsible for depositing only its share of New York's Allocable Share of the OPMs' Potential Maximum NPM Adjustment at issue, as that share is determined pursuant to Section IX(d)(3) of the MSA. On the condition that the Independent Auditor's confirmation described in subsection A.2 has been received and remains operative, each OPM and NewYork shall jointly instruct the Independent Auditor to release each such deposit to New York promptly upon its being made.

3. In connection with the MSA payments due on April 15 of each year beginning with 2016, each SPM other than TABESA and U.S. Flue-Cured shall deposit into the DPA New York's Allocable Share of that SPM's respective Potential Maximum NPM Adjustment for the preceding year, and TABESA and U.S. Flue-Cured shall deposit into the DPA New York's Allocable Share of that SPM's respective Potential Maximum NPM Adjustment for the year preceding the year of payment by three years. On the condition that the Independent Auditor's confirmation described in subsection A.2 has been received and remains operative, each SPM and NewYork shall jointly instruct the Independent Auditor to release each such deposit to New York promptly upon its being made.

4. If, prior to an April 15 Payment Due Date, the Independent Auditor issues Revised Final Calculations for prior year(s) that contain revised NPM Adjustment amounts for prior year(s), the amounts the PMs deposit into the DPA on that Payment Due Date pursuant to paragraphs 2 and 3 shall be based on a "net" adjustment amount, that is, the amount that reflects both the NPM Adjustment amount for the year that is first subject to deposit into the DPA on that Payment Due Date and revisions to prior years' adjustment amounts. For example, if the prior year(s)' adjustment(s) are revised upwards, the PMs shall deposit the amount of the increase into the DPA in addition to the amount to be deposited on that Payment Due Date under paragraphs 2-3; conversely, if the prior year(s)' adjustment(s) are revised downwards, the PMs shall deduct the amount of the decrease from the amount to be deposited on that Payment Due Date under paragraphs 2-3. The amount to be released from the DPA pursuant to paragraphs 2-3 following each deposit will likewise be based on such "net" amounts.

5. If, in addition to making a deposit under paragraphs 2-3, a PM also deposits other Settling State(s)' Allocable Share(s) of an NPM Adjustment into the DPA, the instruction to the Independent Auditor under paragraphs 2-3 (as applicable to that PM) shall direct the release only of the funds specified in the applicable such paragraph. Nothing in this

Agreement shall require or prevent the deposit into or release from the DPA of any other Settling State's Allocable Share of any NPM Adjustment.

III. Settlement Credits

A. For years prior to 2011

The PMs will receive the following credits applied to their payments pursuant to MSA Section IX(c) due on April 15, 2016, (except as otherwise set forth in Appendix B for Farmers, Liggett and Vector Tobacco):

1. The OPMs will receive a credit equal to 10% of New York's proportionate share of the amount currently held in the DPA that was deposited by an OPM and was attributable to any of the 2004-2010 NPM Adjustments (and 10% of the accumulated earnings thereon). The OPMs and New York estimate that the amount of this credit is $52,606,368.61. That amount is subject to verification by the Independent Auditor. This credit shall be allocated among the OPMs as they direct the Independent Auditor.

2. Each SPM will receive a credit equal to the product of (a) the dollar amount of the credit due to the OPMs under paragraph 1 times (b) a fraction the numerator of which is that SPM's total Potential Maximum NPM Adjustments for 2004-2010 and the denominator of which is the OPMs' total Potential Maximum NPM Adjustments for 2004-2010.

B. SET-Paid NPM Sales

1. For 2015 and each year thereafter, unless New York qualifies for the safe harbor for that year under paragraph 5 below, the OPMs shall receive a credit equal to the adjustment amount for that year times the number of Non-Compliant NPM Cigarettes on which New York Excise Tax is paid. The adjustment amount for a year equals three times the escrow amount per Cigarette for that year under § 1399-pp(2)(a) of the Escrow Statute (as such amount is adjusted for inflation pursuant to the Escrow Statute). These credits shall each be allocated among the OPMs as they direct the Independent Auditor.

2. For each year in which the OPMs receive a credit under paragraph 1, each SPM shall receive a credit equal to the product of (a) the dollar amount of the credit due to the OPMs for that year under paragraph 1 times (b) a fraction the numerator of which is that SPM's Potential Maximum NPM Adjustment for that year and the denominator of which is the OPMs' Potential Maximum NPM Adjustment for that year.

3. Except as provided in paragraph 4, as used in this subsection B, "Non-Compliant NPM Cigarettes" means NPM Cigarettes on which New York Excise Tax is paid, but on which escrow was either (a) not deposited at the rate equal to the escrow amount per Cigarette for the sales year at issue under § 1399-pp(2)(a) of the Escrow Statute (as such amount is adjusted for inflation pursuant to the Escrow Statute), or (b) released or refunded other than pursuant to the terms of the Escrow Statute. A deposit of the requisite amount will suffice for purposes of subparagraph (a) if made by the NPM, by any other person or entity liable for the

deposit on the Cigarettes at issue under the Escrow Statute, or by any person or entity in the distribution chain of such Cigarettes on behalf of such NPM.

4. Non-Compliant NPM Cigarettes shall not include:

(a) Cigarettes on which New York recovered at the escrow rate set forth in subparagraph 3(a) on an escrow bond posted pursuant to the laws of New York and did not release or refund any part of the deposit so recovered with respect to the Cigarettes in question other than pursuant to the terms of the Escrow Statute.

(b) Cigarettes as to which New York is barred from enforcing escrow deposits from all entities liable under the Escrow Statute for such deposits, and is also barred from recovery on any remaining escrow bond applicable to such deposits, by an automatic stay or subsequent order in a federal bankruptcy proceeding or by order of a court of competent jurisdiction that enforcing escrow deposits on such Cigarettes is barred by federal or State constitutional law (other than State constitutional provisions added or amended after December 14, 2012 or State constitutional law as it may impact or be applied in relation to sovereign immunity or other Native American issues) or federal statutory or common law. Provided, however, that this subparagraph (b) applies only if: (i) New York uses reasonable efforts to oppose and appeal the stay or order, (ii) within 30 days prior to the time of sale, the NPM and brand at issue were both properly authorized for stamping in New York, either in accordance with Complementary Legislation or pursuant to the order of a court of competent jurisdiction requiring that the NPM and brand be authorized for stamping in New York; and (iii) New York has requirements in effect (x) that the NPM at issue post a bond at least 10 days in advance of each calendar quarter as a condition to its Cigarettes being authorized for stamping in New York in accordance with Complementary Legislation for that quarter in at least an amount equal to the greater of $25,000 or the greatest required escrow amount due from the NPM or its predecessor for any of the 12 preceding calendar quarters, and (y) that importers are jointly and severally liable for escrow deposits due from an NPM with respect to NPM Cigarettes that they import.

5. There will be no credits under this subsection B for a year for which New York demonstrates either (a) that the total number of Non-Compliant NPM Cigarettes sold during that year did not exceed 4% of all NPM Cigarettes on which New York Excise Tax was paid during such year, or (ii) that the total number of Non-Compliant NPM Cigarettes sold during that year did not exceed 2 million Cigarettes. For purposes of this paragraph, the total number of Non-Compliant NPM Cigarettes shall be calculated as if paragraph 4(b) were inapplicable.

6. Credits under this subsection B shall be applied to the PMs' payments pursuant to MSA Section IX(c) due on the April 15 Payment Due Date during the calendar year two years following the year for which the credit is calculated, *e.g.*, the credit for 2015 shall be applied to the payments due on April 15, 2017.

7. If New York does not have Complementary Legislation in full force and effect during any part of any year, paragraph 4(b) shall be inapplicable with respect to NPM Cigarettes sold in that year. If New York does not have Allocable Share Repeal in full force and

effect during any part of any year, NPM Cigarettes on which New York releases escrow in or for that year that would not be released under Allocable Share Repeal shall be treated as Non-Compliant NPM Cigarettes.

8. By July 15 of the year following the year for which the credit is calculated, New York shall provide to the PMs information sufficient to establish (a) the amount of escrow deposited by or on behalf of each NPM for the year at issue on NPM Cigarettes on which New York Excise Tax was paid, as well as any releases or refunds of escrow; (b) the number of NPM Cigarettes on which New York Excise Tax was paid in the year at issue; and (c) the basis for any exclusion under paragraph 4 of NPM Cigarettes from being Non-Compliant NPM Cigarettes. This information shall include copies of all NPM escrow certifications, of all distributor reports showing the volume on which New York Excise Tax was paid, and of any stay or court order upon which a claimed exclusion under paragraph 4(b) is based.

9. If (a) Cigarettes were not counted as Non-Compliant NPM Cigarettes by reason of a stay or order referenced in paragraph 4(b), but that stay or order is then reversed or otherwise becomes no longer operative and the full escrow amount is not then deposited on the Cigarettes at issue; (b) additional or amended information becomes available regarding the number of NPM Cigarettes on which New York Excise Tax was paid or the number of Non-Compliant NPM Cigarettes (including through further reports or audits); or (c) additional escrow is deposited (or recovery on an escrow bond obtained) or is released or refunded other than pursuant to the terms of the Escrow Statute, the credits under this subsection B shall be recalculated and revised accordingly pursuant to the provisions set forth above. If such revision occurs after the credit has been applied (or, in the case of a revision meaning that New York no longer qualifies for the safe harbor under paragraph 5 for a year, if the revision occurs after the credit would have been applied), the resulting underpayment or overpayment shall be applied to the next MSA payment, with interest at Prime Rate. Notwithstanding the foregoing, no revisions will be made after four years following the Payment Due Date of the MSA payment to which the credit at issue is to be applied under paragraph 6, except that such revisions shall be made at any time to the extent that the revision is attributable to releases or refunds of escrow other than pursuant to the provisions of the Escrow Statute.

10. This paragraph 10 shall apply only if, for 2015 or a subsequent year, both of the following conditions are met: (a) the number of NPM Cigarettes on which New York Excise Tax was paid during that year equals or exceeds 40 million; and (b) at least 20% of such NPM Cigarettes are Non-Compliant NPM Cigarettes. If those conditions are met for a year, the PMs will have the option of either receiving credits under this subsection B for that year, or seeking to apply the NPM Adjustment under Sections IX(d)(1)-(2) and (d)(4) of the MSA to New York for that year. The former option will be deemed to have been selected unless PMs with an aggregate Market Share of at least 87% in the year at issue select the latter option after the time for provision of information under paragraph 8, but before the credit for that year is applied under paragraph 6. As of the time of the selection, the meeting of the conditions and whichever selection the PMs make will be final without regard to subsequent changes in the number of Non-Complaint NPM Cigarettes as provided in paragraph 9. If the latter option is selected, the PMs' claim to apply the NPM Adjustment to New York will be subject to all procedures, standards and exemptions under the MSA, except that (i) the provisions of Sections

V.A and V.D of this Agreement will continue to apply, and (ii) the PMs will not contend that New York did not diligently enforce its Qualifying Statute for the year at issue based on New York's non-collection of New York Excise Tax or escrow on Tribal NPM Cigarettes sold to New York consumers. The PMs will receive credits under subsection C for that year regardless which option they select under this paragraph. In determining whether the conditions set forth above are met, paragraph 4(b) will apply if it would be applicable under the terms of that paragraph.

C. Other payments

For each year beginning with 2011, the PMs will receive additional credits that will be calculated and paid as provided below.

1. *2011-2014*

(a) For each year from 2011-2014, the OPMs shall receive a credit equal to 60 cents for every 20 Tribal NPM Cigarettes (a "Tribal NPM Pack") on which New York did not collect New York Excise Tax that were sold during that year to New York consumers. These credits shall each be allocated among the OPMs as they direct the Independent Auditor.

(b) The Parties stipulate solely for purposes of this Agreement that, in each of 2011-2014, 150 million Tribal NPM Packs described in subparagraph (a) were sold. This stipulation does not constitute an admission by any Party that 150 million was the actual volume of such sales or that the actual volume was higher or lower than that number. Based on that stipulation, the dollar amount of the credit to the OPMs under subparagraph (a) is $90 million for each of 2011-2014.

(c) For each year from 2011-2014, each SPM shall receive a credit equal to the product of (i) the dollar amount of the credit due to the OPMs for that year under subparagraphs (a)-(b) times (ii) a fraction the numerator of which is that SPM's Potential Maximum NPM Adjustment for that year and the denominator of which is the OPMs' Potential Maximum NPM Adjustment for that year.

(d) These credits shall be applied to the PMs' payments pursuant to MSA Section IX(c) on the following schedule (except as otherwise set forth in Appendix B for Farmers, Liggett and Vector Tobacco): the credit for 2011 shall be applied to the payments due on April 15, 2016; the credit for 2012 shall be applied to the payments due on April 15, 2017; the credit for 2013 shall be applied to the payments due on April 15, 2018; and the credit for 2014 shall be applied to the payments due on April 15, 2019. The credits applied in April 2017-2019 shall be applied together with interest at the Prime Rate from April 15, 2016.

2. *2015 and subsequent years*

(a) For 2015 and each year thereafter, the OPMs shall receive a credit for each Tribal NPM Pack on which New York did not collect New York Excise Tax that was sold during that year to New York consumers. The amount of the credit for each such Tribal

NPM Pack shall be:

> If the volume of such Tribal NPM Packs in the year at issue is 125 million or more, 70 cents for each such Tribal NPM Pack (i.e., 70 cents for each Pack, including each of the first 125 million Packs);

> If the volume of such Tribal NPM Packs in the year at issue is equal to or greater than 100 million but less than 125 million, 67 cents for each such Tribal NPM Pack (i.e., 67 cents for each Pack, including each of the first 100 million Packs);

> If the volume of such Tribal NPM Packs in the year at issue is equal to or greater than 75 million but less than 100 million, 60.33 cents for each such Tribal NPM Pack (i.e., 60.33 cents for each Pack, including each of the first 75 million Packs);

> If the volume of such Tribal NPM Packs in the year at issue is equal to or greater than 50 million but less than 75 million, 53.67 cents for each such Tribal NPM Pack (i.e., 53.67 cents for each Pack, including each of the first 50 million Packs);

> If the volume of such Tribal NPM Packs in the year at issue is less than 50 million, 47 cents for each such Tribal NPM Pack.

Beginning with the credit for 2016, all cents per Pack numbers in this subparagraph shall be adjusted in accordance with the Inflation Adjustment in the MSA, provided that, in determining the Inflation Adjustment Percentage applicable to such numbers, inflation from 1999-2014 shall not be included. These credits shall each be allocated among the OPMs as they direct the Independent Auditor.

(b) The volume of Tribal NPM Packs described in subparagraph (a) during years beginning with 2015 shall be determined as follows.

(i) For 2015 and every second year thereafter, the Parties shall jointly select and retain an Investigator to determine the number of Tribal NPM Packs on which New York did not collect New York Excise Tax that were sold to New York consumers during the year at issue. The Investigator shall be a company with well-recognized professional experience and skills in investigations and analysis of consumer product markets and distribution and retail operations.

(ii) In the event the Parties do not agree on a joint selection by October 31 of the year for which the determination is being made, an independent Investigator meeting the requirements of clause (i) shall be selected promptly by the International Institute for Conflict Prevention & Resolution, 575 Lexington Avenue, 21st floor, New York, New York 10022 ("CPR") or CPR's successor. The Parties shall jointly retain the Investigator selected by CPR.

(iii) The initial term of the first Investigator will be four years (two determination cycles), except if the Parties otherwise agree or if there is good cause

shown to terminate the Investigator prior to the full term. Good cause consists of actions that fall outside accepted professional practice, and does not include a Party's dissatisfaction with the Investigator's findings.

(iv) By April 15 of the year following the year for which the determination is being made, each side will provide to the other side all information in its possession or control that it will submit to the Investigator in its initial written submission described in clause (v). As used in this subparagraph (b), the respective "sides" are (A) collectively, the OPMs and any SPM having a Market Share above 1% in the year preceding the year for which the determination is being made, and (B) New York.

(v) No later than 45 days after the date in clause (iv), each side may make a written submission to the Investigator. Each side may submit one response to the other side's submission within 30 days. The submissions and responses may include whatever the side believes will be helpful to the Investigator, provided that the submissions and responses may not include or rely on information that the side was required, but failed, to provide to the other side under clause (iv). In the event a side includes or relies on information in violation of the preceding sentence or provides additional information under clause (iv) later than 10 days prior to the due date for responses, the other side may make a further submission to the Investigator addressing such information within 30 days of its receipt.

(vi) The Investigator shall conduct an investigation in accordance with accepted professional practice. In so doing, it will have full discretion to consider the Parties' submissions and responses, to conduct independent research and investigative activities, and to make requests to the Parties.

(vii) The Investigator will make its findings within 120 days of the parties' initial written submissions, except as the Parties may agree to extend that period. The findings shall consist of the Investigator's best professional estimate, based on its investigation, of the number of Tribal NPM Packs on which New York did not collect New York Excise Tax that were sold to New York consumers during the year at issue, along with an accompanying explanation for the estimate. It is expressly agreed by all Parties that the Investigator's findings shall be conclusive, final and binding on all Parties, and that no appeal, request for vacatur or modification or other challenge to them shall be permitted; provided, however, that in the event a side fails to provide material information that the side was required to provide under clause (iv), the other side may request that the Investigator re-open and revise its findings for the year at issue. The Investigator's findings of the number of such NPM Packs shall govern for two years, *e.g.*, the volume of Packs determined for 2015 shall be deemed the volume for 2016 as well. The Investigator's findings shall be confidential and shall not be used for any purposes other than implementation of this Agreement.

(c) For 2015 and each year thereafter, each SPM shall receive a credit equal to the product of (i) the dollar amount of the credit due to the OPMs for that year under subparagraphs (a)-(b) times (ii) a fraction the numerator of which is that SPM's Potential

Maximum NPM Adjustment for that year and the denominator of which is the OPMs' Potential Maximum NPM Adjustment for that year.

(d) These credits shall be applied to the PMs' payments pursuant to MSA Section IX(c) due on the April 15 Payment Due Date during the calendar year two years following the year for which the credit is calculated, *e.g.*, the credit for 2015 shall be applied to the payments due on April 15, 2017.

(e) If New York has a law, regulation, systematic policy or agreement of not collecting New York Excise Tax on any NPM Cigarettes sold to New York consumers other than Tribal NPM Cigarettes, those NPM Cigarettes will give rise to credits under this paragraph 2 and will be included in the volume for purposes of subparagraph (a). If such a law, regulation, systematic policy or agreement exists, the Investigator will determine the volume of such NPM Cigarettes as part of its determination under subparagraph (b) through the process specified in that subparagraph.

D. Instructions

The Parties shall jointly instruct the Independent Auditor to apply all of the credits to be received by the PMs under this Section III, and that these credits shall be allocated solely to New York and shall not be allocated to any other Settling State. With respect to amounts credited against amounts withheld by Farmers, Liggett or Vector Tobacco pursuant to Appendix B, those Parties and New York shall jointly instruct the Independent Auditor that such credit and any release regarding such withheld amount shall not affect the amount potentially owed to any other Settling State from the amounts withheld.

IV. Releases

A. Release by the PMs

1. Except as provided in Section III.B.10, all PMs absolutely and unconditionally release and discharge New York from any Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to the NPM Adjustment or any contention that New York's policy of not collecting New York Excise Tax on Tribal NPM Cigarettes sold to New York consumers violates or breaches requirements or standards under the MSA.

2. The foregoing releases (a) apply to the PMs, their respective past, present and future Affiliates, the respective divisions, officers, directors, employees, agents and legal representatives of each such PM and each such Affiliate, and the successors and assigns of each of the foregoing, and (b) inure to the benefit of New York and its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions, any other person or entity as to which New York has the authority to discharge the Claims specified in subsection B.1, and the successors and assigns of each of the foregoing.

3. The PMs reserve all rights with respect to all other Settling States, including, without limitation, as to the NPM Adjustments for 2003 and subsequent years.

B. Release by New York

1. New York absolutely and unconditionally releases and discharges all PMs from any Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to the 1999-2014 NPM Adjustments, to any PM's withholding or depositing into the DPA of any amounts attributable to any such NPM Adjustment, or to any contention by the PMs that New York's policy of not collecting New York Excise Tax on Tribal NPM Cigarettes sold to New York consumers violates or breaches requirements or standards under the MSA, including, but not limited to, Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to conduct prior to the Effective Date under Executive Law § 63(12), General Business Law § 352, State Finance Law §§ 187 *et seq.*, and N.Y.C.R.R. tit.13, § 400.2. New York withdraws the subpoenas dated April 10, 2014 with prejudice, terminates the investigation referenced therein, will return within 30 days of the Effective Date all documents produced pursuant to those subpoenas (including all copies) and acknowledges that the foregoing release bars it from reinstating those subpoenas or reopening that investigation (or serving other subpoenas or commencing other investigations with respect to the same subject matter directly or indirectly based on, arising out of or in any way related, in whole or in part, to conduct prior to the Effective Date).

2. The foregoing release (a) applies to New York and its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions, any other person or entity as to which New York has the authority to discharge the Claim(s) at issue, and the successors and assigns of each of the foregoing, and (b) inures to the benefit of the PMs, their respective past, present and future Affiliates, the respective divisions, officers, directors, employees, agents and legal representatives of each such PM and each such Affiliate, and the successors and assigns of each of the foregoing.

3. New York reserves all rights with respect to all Participating Manufacturers that are not PMs, including, without limitation, as to the NPM Adjustments for 2003 and subsequent years.

C. Notwithstanding any provision of law, statutory or otherwise, that 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 subsections A-B release all Claims within the scope of the applicable release, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, and each party giving the applicable release understands and acknowledges the significance and consequences of waiver of any such provision of law and hereby assumes full responsibility for any injuries, damages or losses that such party may incur as a result.

D. None of the foregoing releases applies to a Party's obligation to comply with the provisions of this Agreement or is intended to interfere with a Party's ability to enforce such provisions.

V. Miscellaneous

A. No Withholding or DPA. Except as provided in Section II.B, the PMs shall not withhold or deposit into the DPA any amounts attributable to New York based on a dispute within the release under Section IV.A. Nothing herein shall bar the PMs from withholding or depositing into the DPA amounts based on a dispute arising out of this Agreement.

B. Quarterly Certification. Twenty-five percent of a year's credit against the payment of each PM due on the Payment Due Date in each year may be recognized at the end of each quarter of the prior year — that is, on March 31, June 30, September 30, and December 31 (the "quarterly date") — subject to the following condition: Each PM will separately recognize its credits only if the respective PM certifies to the Independent Auditor, on or before each quarterly date, that New York's share of that PM's MSA payment that will be due on the Payment Due Date immediately following that year based on that PM's shipments of Cigarettes during that quarter as reported to Management Science Associates, Inc. (for purposes of this paragraph, "New York's share") equals or exceeds the amount of the credit to be recognized by that PM on that quarterly date. If a PM does not so certify, then in that quarter it will recognize its credit only for the amount that such PM does certify that New York's share will be; if, due to this paragraph, the twenty-five percent of a year's credit is not recognized in full by a PM on a quarterly date, then the unrecognized amount of that credit will be recognized in a subsequent quarter (or quarters) of that year for the amount that the PM certifies in that subsequent quarter that New York's share is sufficient. A PM may elect to opt out of the certification process described above for a stated period of time by notice to New York. If a PM does opt out of that process, nothing in this subsection B shall require it to account or prohibit it from accounting for the credits in a particular manner or to recognize or prohibit it from recognizing them at a particular time.

C. Disputes. Except as otherwise provided in this Agreement, disputes under this Agreement shall be resolved through binding arbitration between the interested PMs (as a side) and New York (as a side).

D. Significant Factor. The significant factor condition under MSA Section IX(d)(1)(C) shall no longer be operative as to New York and shall be deemed satisfied as to New York for each year.

E. RYO. For purposes of determining the number of Non-Compliant NPM Cigarettes pursuant to Section III.B, references to a number of Cigarettes include roll-your-own tobacco, with 0.09 ounces of "roll-your-own" tobacco constituting one individual Cigarette. For all other purposes of this Settlement Agreement, references to a number of Cigarettes include roll-your-own tobacco, with 0.0325 ounces of "roll-your-own" tobacco constituting one individual Cigarette. This provision does not apply to determining Relative Market Shares for purposes of allocating any aggregate OPM amounts among the OPMs.

F. Allocated Payment. Credits due to a PM under this Agreement shall be applied against the MSA payment to New York due from that PM to which this Agreement specifies those credits are to be applied. If a PM does not have an MSA payment to New York that is sufficient to bear the full credit to which it is entitled under this Agreement in that year, that PM may transfer the excess credit to another PM(s) and the transferred credit will be applied against an MSA payment to New York due from the transferee PM(s). As used in this subsection, with respect to credits due to an OPM, the MSA payment to New York means that OPM's share of New York's Allocated Payment with respect to the payment at issue, without regard to whether any part of that Allocated Payment is to be received by a political subdivision of New York, bondholder or any other person or entity; and with respect to credits due to an SPM, the MSA payment to New York means New York's Allocable Share of that SPM's payment with respect to the payment at issue, without regard to whether any part of that payment is to be received by a political subdivision of New York, bondholder or any other person or entity.

G. Business Days. Any obligation under this Agreement 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.

H. Counterparts. This Agreement may be executed in counterparts. Electronically transmitted, facsimile or photocopied signatures shall be considered valid as of the date affixed, although the original signature pages shall thereafter be appended.

I. Intended Beneficiaries. Except as provided in Sections IV.A-B, no portion of this Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a Party. Further, except as provided in Sections IV.A-B, the Parties to this Agreement confirm that this Agreement does not confer rights on third parties.

J. Notices. All notices and other communications under this Agreement shall be in writing and shall be deemed received (i) immediately if sent by electronic mail, or (ii) the next Business Day if sent by nationally recognized overnight courier to the respective address as provided by the recipient.

K. Non-Admissibility. No evidence of the negotiations of this Agreement, or any drafts of this Agreement, shall be admissible in any dispute between or among the Parties as to the meaning of this Agreement.

L. No Drafter. No Party shall be considered the drafter of this Agreement, or any provision thereof, 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.

M. Headings. The headings in 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.

N. Cooperation. Each Party agrees to use its best efforts and to cooperate with the other Parties to cause this Agreement 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 Party agrees that it will not directly or indirectly assist or encourage any challenge to this Agreement by any other person or entity, will support the integrity and enforcement of the terms of this Agreement, and will cooperate to issue the instructions to the Independent Auditor required by this Agreement.

O. Non-Release. Nothing in this Agreement shall limit, prejudice or otherwise interfere with the rights (1) of any PM to pursue any and all rights and remedies it may have against any other Settling State or (2) of New York to pursue any and all rights and remedies it may have against any Participating Manufacturer that is not a PM.

P. Representation of Parties. Each Party hereby represents that this Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation of each of them, enforceable in accordance with its terms. The signatories to this Agreement expressly represent and warrant (1) that they have the authority to settle and resolve all matters within the scope of this Agreement on behalf of their respective Parties; (2) that, in the case of the signatory on behalf of a PM, the signatory has authority to settle and release all claims within the scope of the release under Section IV.A.1 on behalf of that PM and all persons or entities listed in Section IV.A.2(a) with respect to that PM and that the signatory is aware of no authority to the contrary; and (3) that, in the case of the signatory on behalf of New York, the signatory has authority to settle and release all claims within the scope of the release under Section IV.B.1 on behalf of New York and all persons or entities listed in Section IV.B.2(a) and that the signatory is aware of no authority to the contrary.

Q. Entire Agreement. This 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 the settlement and resolution of the specified claims and disputes as among them.

R. No 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 any liability, breach of obligation or any wrongdoing whatsoever on the part of any Party.

IN WITNESS THEREOF, the Parties, through their fully authorized representatives, have agreed to this Agreement as of the Effective Date.

ERIC T. SCHNEIDERMAN

Attorney General of the State of New York

By: _____
Dana Biberman
Bureau Chief, Tobacco Compliance Bureau

Date: _____

PHILIP MORRIS USA INC.

By: _____
Clifford B. Fleet
President and Chief Executive Officer

Date: 10/13/15

R. J. REYNOLDS TOBACCO COMPANY, in its own capacity and as successor in interest to Brown & Williamson Tobacco Corporation and as successor in interest to Lorillard Tobacco Company

By: _____
Martin L. Holton III
Executive Vice President & General Counsel

Date: _____

COMMONWEALTH BRANDS, INC.

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

COMPANIA INDUSTRIAL DE TABACOS MONTE PAZ, S.A.

By: _____
Dr. Manuel Moldes
General Manager

Date: _____

By: _____
Jorge Luis Mailhos
President

Date: _____

DAUGHTERS & RYAN, INC.

By: _____
Mark Ryan
President

Date: _____

COMMONWEALTH BRANDS, INC.

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

COMPANIA INDUSTRIAL DE TABACOS MONTE PAZ, S.A.

By: _____
Dr. Manuel Moldes
General Manager

Date: 10. 16. 2015

By: _____
Jorge Luis Mailhos
President

Date: 10. 16. 2015

DAUGHTERS & RYAN, INC.

By: _____
Mark Ryan
President

Date: _____

COMMONWEALTH BRANDS, INC.

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

COMPANIA INDUSTRIAL DE TABACOS MONTE PAZ, S.A.

By: _____
Dr. Manuel Moldes
General Manager

Date: _____

By: _____
Jorge Luis Mailhos
President

Date: _____

DAUGHTERS & RYAN, INC.

By: Elizabeth B. McCallum
Elizabeth B. McCallum
Counsel

Date: 10-13-15

ETS L. LACROIX FILS S.A. (BELGIUM)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

FARMER'S TOBACCO CO. OF CYNTHIANA, INC.

By: _____
Desha Henson
President

Date: _____

HOUSE OF PRINCE A/S

By: _____
Peter Helbo
Board Member

Date: _____

By: _____
James Yanamaka
Chief Executive Officer

Date: _____

IMPERIAL TOBACCO LIMITED (UK)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

ETS L LACROIX FILS S.A. (BELGIUM)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

FARMER'S TOBACCO CO. OF CYNTHIANA, INC.

By: Desha Henson
Desha Henson
President

Date: 10/13/15

HOUSE OF PRINCE A/S

By: _____
Peter Helbo
Board Member

Date: _____

By: _____
James Yanamaka
Chief Executive Officer

Date: _____

IMPERIAL TOBACCO LIMITED (UK)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

ETS L LACROIX FILS S.A. (BELGIUM)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

FARMER'S TOBACCO CO. OF CYNTHIANA, INC.

By: _____
Desha Henson
President

Date: _____

HOUSE OF PRINCE A/S

By: _____
Peter Helbo
Board Member

Date: 12 OCT 2015

By: _____
James Yanamaka
Chief Executive Officer

Date: 12 Oct 2015

IMPERIAL TOBACCO LIMITED (UK)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

IMPERIAL TOBACCO MULLINGAR (IRELAND)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

IMPERIAL TOBACCO POLSKA S.A. (POLAND)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

IMPERIAL TOBACCO PRODUCTION UKRAINE

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

IMPERIAL TOBACCO SIGARA VE TUTUNCULUK SANAYI VE TICARET S.A. (TURKEY)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

ITG BRANDS, LLC (FORMERLY LIGNUM-2, LLC)

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

JAPAN TOBACCO INTERNATIONAL U.S.A., INC.

By: _____
Jacques Coffing
President

Date: _____

By: _____
Michael Mete
Chief Financial Officer

Date: _____

KING MAKER MARKETING, INC.

By: _____
Bhavani Parameswar
President and Chief Financial Officer

Date: _____

ITG BRANDS LLC., (FORMERLY LIGNUM-2, LLC)

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

JAPAN TOBACCO INTERNATIONAL U.S.A., INC.

By: _____
Jacques Coffing
President

Date: October 15, 2015

By: _____
Michael Mete
Chief Financial Officer

Date: October 15, 2015

KING MAKER MARKETING, INC.

By: _____
Elizabeth B. McCallum
Counsel

Date: _____

ITG BRANDS LLC., (FORMERLY LIGNUM-2, LLC)

By: _____
Rob Wilkey
General Counsel and Secretary

Date: _____

JAPAN TOBACCO INTERNATIONAL U.S.A., INC.

By: _____
Jacques Coffing
President

Date: _____

By: _____
Michael Mete
Chief Financial Officer

Date: _____

KING MAKER MARKETING, INC.

By: Elizabeth B. McCallum
Elizabeth B. McCallum
Counsel

Date: 10-13-15

KRETEK INTERNATIONAL, INC.

By: _____
Henry C. Roemer
Counsel

Date: October 13, 2015

LIGGETT GROUP LLC

By: _____
John Long
Vice President and General Counsel

Date: _____

000 TABAKSFABRIK REEMTSMA WOLGA (RUSSIA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

PETER STOKKEBYE TOBAKSFABRIK A/S

By: _____
Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

KRETEK INTERNATIONAL, INC.

By: _____
Henry C. Roemer
Counsel

Date: _____

LIGGETT GROUP LLC

By: _____
John Long
Vice President and General Counsel

Date: October 12, 2015

000 TABAKSFABRIK REEMTSMA WOLGA (RUSSIA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

PETER STOKKEBYE TOBAKSFABRIK A/S

By: _____
Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

KRETEK INTERNATIONAL, INC.

By: _____
Henry C. Roemer
Counsel

Date: _____

LIGGETT GROUP LLC

By: _____
John Long
Vice President and General Counsel

Date: _____

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Rob Wilkey
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Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

KRETEK INTERNATIONAL, INC.

By: _____
Henry C. Roemer
Counsel

Date: _____

LIGGETT GROUP LLC

By: _____
John Long
Vice President and General Counsel

Date: _____

000 TABAKSFABRIK REEMTSMA WOLGA (RUSSIA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

PETER STOKKEBYE TOBAKSFABRIK A/S

By: _____
Mette Valentin, Board member
Senior Vice President, Legal and Public Affairs

Date: 12 October 2015

Sisse Fjelsted Rasmussen
Board Member

PREMIER MANUFACTURING, INC.

By: _____
Stuart D. Thompson
Chief Executive Officer

Date: October 13, 2015

P.T. DJARUM

By: _____
Henry C. Roemer
Counsel

Date: _____

REEMTSMA CIGARETTENFABRIKEN GMBH (REEMTSMA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

SANTA FE NATURAL TOBACCO COMPANY, INC.

By: _____
Michael Little
President

Date: _____

PREMIER MANUFACTURING, INC.

By: _____
Stuart D. Thompson
Chief Executive Officer

Date: _____

P.T. DJARUM

By: _____
Henry C. Roemer
Counsel

Date: October 13, 2015

REEMTSMA CIGARETTENFABRIKEN GMBH (REEMTSMA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

SANTA FE NATURAL TOBACCO COMPANY, INC.

By: _____
Michael Little
President

Date: _____

PREMIER MANUFACTURING, INC.

By: _____
Stuart D. Thompson
Chief Executive Officer

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P.T. DJARUM

By: _____
Henry C. Roemer
Counsel

Date: _____

REEMTSMA CIGARETTENFABRIKEN GMBH (REEMTSMA)

By: _____
Rob Wilkey
Authorized Signatory

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SANTA FE NATURAL TOBACCO COMPANY, INC.

By: _____
Michael Little
President

Date: _____

PREMIER MANUFACTURING, INC.

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Stuart D. Thompson
Chief Executive Officer

Date: _____

P.T. DJARUM

By: _____
Henry C. Roemer
Counsel

Date: _____

REEMTSMA CIGARETTENFABRIKEN GMBH (REEMTSMA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

SANTA FE NATURAL TOBACCO COMPANY, INC.

By: _____
Michael Little
President

Date: 10-12-15

22

SCANDINAVIAN TOBACCO GROUP LANE LTD (FORMERLY LANE LIMITED)

By: _____
~~Mette Valentin~~
~~Senior Vice President, Legal and Public Affairs~~
W. David Parrish
VP, Finance + IT

Date: Oct 12, 2015

SHERMAN 1400 BROADWAY N.Y.C., INC.

By: _____
Brendon Scott
Vice President and Chief Financial Officer

Date: _____

SOCIETE NATIONAL D'EXPLOITATION INDUSTRIELLE DES TABACS ET ALLUMETTES (SEITA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

TABACALERA DEL ESTE S/A (TABESA)

By: _____
Stephen Johnson
Director and Secretary

Date: _____

SCANDINAVIAN TOBACCO GROUP LANE LTD (FORMERLY LANE LIMITED)

By: _____
Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

SHERMAN 1400 BROADWAY N.Y.C., INC.

By: _____
Brendon Scott
Vice President and Chief Financial Officer

Date: October 12, 2015

SOCIETE NATIONAL D'EXPLOITATION INDUSTRIELLE DES TABACS ET ALLUMETTES (SEITA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

TABACALERA DEL ESTE S/A (TABESA)

By: _____
Stephen Johnson
Director and Secretary

Date: _____

23

SCANDINAVIAN TOBACCO GROUP LANE LTD (FORMERLY LANE LIMITED)

By: _____
Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

SHERMAN 1400 BROADWAY N.Y.C., INC.

By: _____
Brendon Scott
Vice President and Chief Financial Officer

Date: _____

SOCIETE NATIONAL D'EXPLOITATION INDUSTRIELLE DES TABACS ET ALLUMETTES (SEITA)

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Rob Wilkey
Authorized Signatory

Date: _____

TABACALERA DEL ESTE S/A (TABESA)

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Stephen Johnson
Director and Secretary

Date: _____

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Mette Valentin
Senior Vice President, Legal and Public Affairs

Date: _____

SHERMAN 1400 BROADWAY N.Y.C., INC.

By: _____
Brendon Scott
Vice President and Chief Financial Officer

Date: _____

SOCIETE NATIONAL D'EXPLOITATION INDUSTRIELLE DES TABACS ET ALLUMETTES (SEITA)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

TABACALERA DEL ESTE S/A (TABESA)

By: _____
Stephen Johnson
Director and Secretary

Date: October 13, 2015

23

TOP TOBACCO, L.P.

By: _____
Seth Gold
General Counsel

Date: October 12, 2015

VAN NELLE TABAK NEDERLAND B.V. (NETHERLANDS)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

U.S. FLUE-CURED TOBACCO GROWERS, INC.

By: _____
Stuart D. Thompson
Senior Vice President

Date: _____

VECTOR TOBACCO INC.

By: _____
Nick Anson
Vice President–Finance & Chief Financial Officer

Date: _____

TOP TOBACCO, L.P.

By: _____
Seth Gold
General Counsel

Date: _____

VAN NELLE TABAK NEDERLAND B.V. (NETHERLANDS)

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Rob Wilkey
Authorized Signatory

Date: _____

U.S. FLUE-CURED TOBACCO GROWERS, INC.

By: _____
Stuart D. Thompson
Senior Vice President

Date: _____

VECTOR TOBACCO INC.

By: _____
Nick Anson
Vice President–Finance & Chief Financial Officer

Date: _____

24

TOP TOBACCO, L.P.

By: _____
Seth Gold
General Counsel

Date: _____

VAN NELLE TABAK NEDERLAND B.V. (NETHERLANDS)

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Rob Wilkey
Authorized Signatory

Date: _____

U.S. FLUE-CURED TOBACCO GROWERS, INC.

By: _____
Stuart D. Thompson
Senior Vice President

Date: October 13, 2015

VECTOR TOBACCO INC.

By: _____
Nick Anson
Vice President–Finance & Chief Financial Officer

Date: _____

TOP TOBACCO, L.P.

By: _____
Seth Gold
General Counsel

Date: _____

VAN NELLE TABAK NEDERLAND B.V. (NETHERLANDS)

By: _____
Rob Wilkey
Authorized Signatory

Date: _____

U.S. FLUE-CURED TOBACCO GROWERS, INC.

By: _____
Stuart D. Thompson
Senior Vice President

Date: _____

VECTOR TOBACCO INC.

By: _____
Nick Anson
Vice President -Finance & Chief Financial Officer

Date: October 12, 2015

VON EICKEN GROUP

By: _____
Henry C. Roemer
Counsel

Date: October 13, 2015

WIND RIVER TOBACCO COMPANY INC.

By: _____
Mark Mansfield
President

Date: _____

VON EICKEN GROUP

By: _____
Henry C. Roemer
Counsel

Date: _____

WIND RIVER TOBACCO COMPANY INC.

By: _____
Mark Mansfield
President

Date: 10/13/15

APPENDIX A

SPM Estimated DPA Releases to New York (Without Earnings)

	IX(c)(1)	IX(c)(2)
Commonwealth Brands, Inc.	29,326,724.33	1,022,078.39
Compania Industrial de Tabacos Monte Paz	1,783.60	81.13
Daughters & Ryan, Inc.	0.00	0.00
Farmers Tobacco Co.	174,196.57	7,923.44
House of Prince A/S	250.01	2.04
Japan Tobacco International U.S.A., Inc.	1,079,876.88	45,330.89
King Maker Marketing, Inc.	814,189.10	27,461.32
Kretek International	101,850.50	2,752.69
Scandinavian Tobacco Group Lane Limited	106,545.26	10,528.92
Liggett Group LLC	6,256,722.96	287,099.81
ITG Brands	1,021,017.98	44,961.44
Peter Stokkebye Tobaksfabrik A/S	72,338.32	2,460.56
Premier Manufacturing, Inc.	491,981.90	22,378.11
P.T. Djarum	380,892.35	10,618.74
Reemtsma Cigarettenfacbriken Gmbh	0.00	0.00
Santa Fe Natural Tobacco Company, Inc.	4,010,677.07	182,428.17
Sherman 1400 Broadway N.Y.C., Inc.	137,627.98	5,088.63
TABESA	29,518.95	1,342.69
Top Tobacco, L.P.	0.00	0.00
U.S. Flue-Cured Tobacco Growers, Inc.	67,553.82	3,072.73
Vector Tobacco Inc.	579,785.95	26,371.93
Von Eicken Group	10,346.53	385.10
Wind River Tobacco Company, LLC	1,454.90	66.18
Total	44,665,334.95	1,702,432.90

APPENDIX B

Treatment of SPM Withheld Amounts for 2004-2014 NPM Adjustments

(A) With respect to the three SPMs, Farmers Tobacco Company of Cynthiana, Inc. ("Farmers"), Liggett Group LLC ("Liggett"), and Vector Tobacco Inc. ("Vector Tobacco"), that withheld amounts with respect to various NPM Adjustments from 2004-2014, the parties agree that Chart 1 below shows the total amount that each such SPM originally withheld with respect to NPM Adjustments over those years and New York's Allocable Share of those amounts, with New York's total share of the amounts withheld ("NY's Share of Withheld Amounts") shown in Column 5 of Chart 1:

Chart 1

	(1) IX(c)(1) Amounts Withheld*	(2) NY Share of IX(c)(1) Amounts Withheld	(3) IX(c)(2) Amounts Withheld*	(4) NY Share of IX(c)(2) Amounts Withheld	(5) Total NY Share of Amounts Withheld
Farmers	18,593,179.22	2,715,791.71	1,170,434.95	76,804.69	2,792,596.40
Liggett	40,899,003.07	5,219,543.45	3,199,627.59	175,574.45	5,395,117.90
VectorTobacco	2,418,455.64	308,644.06	206,174.12	11,313.48	319,957.53

* For ease of calculation of New York's Allocable Share of the withheld amounts, this chart reflects total amounts withheld for 2004 through 2014 before the effect of the settlement with 24 Settling States.

(B) Farmers, Liggett, and Vector Tobacco shall receive their settlement credits under section III of this agreement and address payment of NY's Share of Withheld Amounts as follows:

(i) First, on April 15, 2016 the credit due for NPM Adjustments from 2004-2010 under subsection III.A of this agreement shall be applied against NY's Share of Withheld Amounts.

(ii) Second, on April 15, 2016 the credits due for NPM Adjustments for NPM Adjustments from 2011-2014 under subsection III.C of this agreement, without any interest, shall be applied against NY's Share of Withheld Amounts, starting with the 2011 credit first and continuing with the 2012, 2013, and 2014 credits until the credits are fully applied or NY's Share of Withheld Amounts is exhausted.

(iii) If NY's Share of Withheld Amounts exceeds the total credits for 2004-2010 and 2011-14 for any of Farmers, Liggett, or Vector Tobacco, then that SPM shall pay the excess of NY's Share of Withheld Amounts over the credits for 2004-10 and 2011-14 into the DPA for payment to New York on or before April 15, 2016. If the total credits for 2004-2010 and 2011-2014 for any of Farmers, Liggett, or Vector Tobacco exceed NY's Share of Withheld

Amounts, any excess credit shall be applied against that SPM's MSA Section IX(c) payment in the year it is applied to payments for the other PMs, with interest if applicable on such excess credit at the Prime Rate from April 15, 2016. The parties agree that the effect of this process for each SPM based on estimated credits is shown in Chart 2 below:

Chart 2

	(1) NY Total Share of Withheld Amounts	(2) Total Settlement Credits for 2010-14	(3) Portion of Withheld Amount Paid to NY, if NY's Share of Withheld Amounts is Greater than Credits for 2010-14	(4) Portion of Total Settlement Credit Applied to MSA Payments, if NY's Share of Withheld Amounts is Less than Credits for 2010-14
Farmers	2,792,596.40	1,053,743.90	1,738,852.50	0.00
Liggett	5,395,117.90	7,198,331.55	0	1,803,213.65
Vector Tobacco	319,957.53	596,254.61	0	276,297.08

For Liggett, for instance, the process works as follows: New York's share of the total amount withheld is $5,395,117.90. Liggett's 2004-2010 credit in the estimated amount of $424,526.01, its 2011 credit in the estimated amount of $2,083,024.71, and its 2012 credit in the estimated amount of $1,868,461.40 shall first be applied against the amount withheld, reducing the outstanding portion of the New York's share of the amount withheld to $1,019,105.77. Liggett's 2013 credit is estimated at $1,527,668.70. A portion of that estimated credit, in the amount of $1,019,105.77, shall then be applied to the remaining amount withheld for New York, reducing the outstanding amount withheld to $0. The remaining portion of Liggett's 2013 credit, $508,562.93, shall be applied against its MSA Section IX(c) payments due on April 15, 2018, with interest on that amount at the Prime Rate from April 15, 2016, and Liggett further shall receive its credit for 2014 in the amount of $1,294,650.73 plus interest at the Prime Rate from April 15, 2016 on April 15, 2019.

(C) Upon application of credits on April 15, 2016 and/or payment into the DPA, as applicable, of the amounts set forth in Chart 2 above, New York agrees that this settlement fully resolves any further claim to its Allocable Share of all amounts previously withheld with respect to the NPM Adjustment for 2004-14 for Farmers, Liggett, and Vector Tobacco, in the amounts listed in Chart 1, Column 5, and releases any claim to those amounts, along with any claim to interest or earnings thereon (including, for purposes of clarity in light of recent instructions from the Independent Auditor, any claim to interest or earnings thereon dating back to the date such amount was originally withheld). Upon such payment, New York and Farmers, Liggett, and

Vector Tobacco shall jointly direct the Independent Auditor to reflect in all appropriate calculation or summaries that the total amounts shown as withheld and/or unpaid, plus all interest or earnings on such amounts from the date such amount was originally withheld, shall be reduced by New York's Allocable Share, in the amounts set forth in Chart 1, Column 5, plus all interest or earnings thereon from the date such amount was originally withheld. New York's release of any further claim to withheld amounts shall continue and be effective even if the Independent Auditor does not reflect the reductions in withheld amounts or interest or earnings fully or correctly.

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APPENDIX E

TSASC FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED JUNE 30, 2016 AND 2015

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TSASC, INC.

A COMPONENT UNIT OF THE CITY OF NEW YORK

Financial Statements
(Together with Independent Auditors' Report)

Years Ended June 30, 2016 and 2015

MARKS PANETH
ACCOUNTANTS & ADVISORS

TSASC, INC.

FINANCIAL STATEMENTS
(Together with Independent Auditors' Report)

YEARS ENDED JUNE 30, 2016 AND 2015

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MARKS PANETH
ACCOUNTANTS & ADVISORS

INDEPENDENT AUDITORS' REPORT

To the Members of the Board of Directors of
TSASC, Inc.

We have audited the accompanying financial statements of the governmental activities of TSASC, Inc. ("TSASC"), a component unit of The City of New York, as of and for the years ended June 30, 2016 and 2015, which collectively comprise TSASC's basic financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities of TSASC, Inc. as of June 30, 2016 and 2015, and the respective changes in financial position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

An independent member of
Morison International

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Marks Paneth LLP

New York, NY
September 22, 2016

The following is a narrative overview and analysis of the financial activities of TSASC, Inc. ("TSASC") for the fiscal years ended June 30, 2016 and 2015. It should be read in conjunction with TSASC's government-wide financial statements, governmental funds financial statements and the notes to the financial statements. The financial statements consist of four parts: (1) management's discussion and analysis (this section); (2) the government-wide financial statements; (3) the governmental funds financial statements; and (4) the notes to the financial statements.

The government-wide financial statements, which include the statements of net position (deficit) and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with Governmental Accounting Standards Board ("GASB") standards. This is to provide the reader with a broad overview of TSASC's finances. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Accordingly, revenue is recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows.

TSASC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting, in which revenue is recognized when it becomes susceptible to accrual; that is, when it becomes both measurable and available to finance expenditures in the current fiscal period. As such, revenues are considered available if received within two months after the fiscal year end. Expenditures are recognized when the related liability is incurred, except for principal and interest on bonds payable, which are recognized when due.

The reconciliations of the governmental funds balance sheets to the statements of net position (deficit) and the reconciliations of the governmental funds statements of revenues, expenditures and changes in fund balances to the statements of activities are presented to assist the reader in understanding the differences between government-wide and governmental funds financial statements.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS

On February 8, 2006, TSASC issued $1.35 billion of Series 2006-1 bonds, the proceeds of which were used to restructure all of TSASC's outstanding indebtedness. After the restructuring, 62.6% of TSASC's annual collection of Tobacco Settlement Revenues ("TSRs") and the related interest earnings are transferred to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate. The City of New York (the "City") is the beneficial owner of the Trust and the funds received by the Trust, net of the Trust's expenses, are transferred to the City. During fiscal years 2016 and 2015, the Trust transferred to the City $229.0 million and $113.4 million, respectively.

The Amended and Restated Indenture dated January 1, 2006, (the "Indenture") provides that a defined portion of the TSRs and other revenues (collectively, "Collections") are applied to the payment of the Series 2006-1 debt service. The proportion of Collections pledged to the payment of the Series 2006-1 debt service is currently 37.4% and is subject to reduction at June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the Series 2006-1 bond turbo redemption feature. The turbo redemption feature requires all the pledged Collections, after funding of operating costs, be applied to the payment of principal and interest on the Series 2006-1 bonds.

The Master Settlement Agreement ("MSA"), dated November 23, 1998, is an industry-wide settlement of litigation between participating cigarette manufacturers and 46 States (the "Settling States"), including the State of New York (the "State"). The MSA governs the amount of TSRs received by TSASC, which is 3.4% of total TSRs paid by the participating cigarette manufacturers. TSRs reflect numerous adjustments as described in the MSA, including adjustments relating to inflation, sales volume, non-settling states, sales by non-participating manufacturers (the "NPM Adjustment"), and miscalculated or disputed payments.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

Under the MSA's dispute-resolution procedures, the tobacco companies withheld over $700 million in combined annual settlement payments to New York State and its counties, including New York City, since 2003 in connection with a dispute relating to the NPM Adjustment.

In 2013, an arbitration panel ruling found that New York State had met its obligations in connection with the NPM Adjustment, which allowed for the release of $92 million of TSRs withheld in that year, including $28.4 million to TSASC.

In 2015, New York State entered into an agreement with the tobacco companies that resolved all past and future disputes relating to the NPM adjustment. The settlement allowed for:

- Release of 90% of withheld TSRs between 2004 through 2014;
- Future TSRs payment in accordance with a set formula reflecting a discount tied to the volume of cigarettes manufactured and sold on Native American reservations; and
- The termination of further disputed withholdings related to the NPM Adjustment.

The settlement does not preclude disputes related to other adjustments. The State received a total of $701 million from the disputed escrow account, of which TSASC received $176 million.

TSASC has no control over the amount of TSRs it receives. Risks in connection with future receipts of TSRs include litigation involving the participating manufacturers ("PM") and could lead to bankruptcy of the PMs, continuing increased decline in cigarette consumption materially beyond forecasted levels, tobacco excise taxes, restrictions on smoking in public areas, and other unforeseen future adjustments to the calculation of TSRs. Further, adverse court rulings, independent of the settlement, could impact upon future MSA payments to TSASC. Reductions in payments to TSASC could impair TSASC's ability to meet its payment obligations.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

The following summarizes the activities of TSASC for the years ended June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
	--------in thousands------			--------in thousands------	
Revenues:					
Tobacco settlement revenue	$ 368,783	$ 180,094	$ 211,616	$ 188,689	$ (31,522)
Investment earnings	1,271	503	943	768	(440)
Total revenues	370,054	180,597	212,559	189,457	(31,962)
Expenses:					
Transfer to the Trust	230,910	112,743	132,474	118,167	(19,731)
Interest expense	62,359	63,002	63,774	(643)	(772)
Other	423	440	440	(17)	-
Total expenses	293,692	176,185	196,688	117,507	(20,503)
Change in net position	76,362	4,412	15,871	71,950	(11,459)
Net position (deficit), beginning of year	(1,056,738)	(1,061,150)	(1,077,021)	4,412	15,871
Net position (deficit), end of year	$ (980,376)	$ (1,056,738)	$ (1,061,150)	$ 76,362	$ 4,412

TSRs generally earned during the fiscal year are based upon tobacco sales of the previous calendar year; adjusted by factors such as inflation, volume, and disputed amounts deposited by the participating cigarette manufacturers into a MSA disputed escrow account. TSASC earned TSRs of approximately $368.8 million, $180.1 million, and $211.6 million in fiscal years 2016, 2015 and 2014, respectively. TSRs increased by approximately $188.7 million in fiscal year 2016 compared to fiscal year 2015. The large increase of tobacco revenue in fiscal year 2016 was primarily due to the release of funds from the disputed escrow account from the settlement related to the years 2004 through 2014, as previously discussed. The decrease in revenue in fiscal year 2015 compared to fiscal year 2014 was also due to a release of disputed funds received in fiscal year 2014. An arbitration panel ruling found that NYS had met its diligent enforcement obligation under the MSA for 2003, which resulted in a release of $28.4 million in fiscal year 2014. In addition, variances in TSRs from one year to another are caused by fluctuations in tobacco sales.

The variances of investment earnings in fiscal years 2016, 2015 and 2014 were primarily attributable to market value fluctuations of long-term investments.

Transfers to the Trust are based on TSRs received during the fiscal year and fluctuated each year, as previously discussed. Interest expense decreases each fiscal year because of the declining bond principal balances, which are being reduced by the turbo redemption feature. Other expenses in fiscal years 2016, 2015 and 2014 were composed of general and administrative costs.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS – GOVERNMENT-WIDE FINANCIAL STATEMENTS (continued)

The following summarizes TSASC's assets, liabilities, and net position (deficit) as of June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
	--------in thousands------			--------in thousands------	
Assets:					
Total assets - non-capital	$ 193,255	$ 191,595	$ 192,861	$ 1,660	$ (1,266)
Liabilities:					
Current liabilities	53,025	51,464	52,114	1,561	(650)
Long-term liabilities	1,120,606	1,196,869	1,201,897	(76,263)	(5,028)
Total liabilities	1,173,631	1,248,333	1,254,011	(74,702)	(5,678)
Net position (deficit):					
Unrestricted	(980,376)	(1,056,738)	(1,061,150)	76,362	4,412
Net position (deficit), end of year	$ (980,376)	$ (1,056,738)	$ (1,061,150)	$ 76,362	$ 4,412

TSASC's total assets for the fiscal years 2016, 2015 and 2014 primarily consisted of cash equivalents and investments restricted for debt service and of TSRs due to TSASC at fiscal year-end.

Current liabilities are composed of accrued operating expenses, accrued interest expenses and TSRs payable to the Trust. Long-term liabilities decreased significantly in fiscal year 2016 due to the settlement and turbo redemption feature (Note 1) of the Series 2006-1 bonds. Long-term liabilities decreased in fiscal year 2015 due to the turbo redemption feature and the amortization of bond discount.

The year-end net position (deficit) was caused by the issuance of the Series 2006-1 bonds. These bonds will be paid from future TSRs, with the final stated maturity occurring in fiscal year 2042.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS

TSASC reports governmental activity using two funds: (1) a general fund ("GF") and (2) a debt service fund ("DSF").

The following summarizes the changes in the GF for the years ended June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
		--------in thousands------		--------in thousands------	
Revenues:					
Tobacco settlement revenue	$ 229,332	$ 113,781	$ 132,932	$ 115,551	$ (19,151)
Investment earnings	54	5	2	49	3
Total revenues	229,386	113,786	132,934	115,600	(19,148)
Expenditures:					
Transfer to the Trust	229,032	113,369	132,474	115,663	(19,105)
Other	423	440	440	(17)	-
Total expenditures	229,455	113,809	132,914	115,646	(19,105)
Net change in fund balances	(69)	(23)	20	(46)	(43)
Fund balances, beginning of year	777	800	780	(23)	20
Fund balances, end of year	$ 708	$ 777	$ 800	$ (69)	$ (23)

Revenues recorded in the GF are primarily composed of TSRs collected each year. As the majority of TSRs recorded in the GF belongs to the Trust and are also recorded as expenditures, there is very little net impact on the GF fund balance. The large increase in the 2016 TSRs and offsetting transfer to trusts was due to the settlement agreement, as previously discussed.

The remaining TSRs not transferred to the Trust are used for operations. This amount fluctuates each year based on management's time spent on conducting TSASC's operations, which determines the amount of general administrative costs.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS (continued)

The following summarizes the changes in TSASC's DSF for the years ended June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
		--------in thousands------		--------in thousands------	
Revenues:					
Tobacco settlement revenue	$ 136,451	$ 67,313	$ 78,684	$ 69,138	$ (11,371)
Investment earnings	1,217	498	941	719	(443)
Total revenues	137,668	67,811	79,625	69,857	(11,814)
Expenditures:					
Interest expenditure	61,419	61,720	62,530	(301)	(810)
Principal amount of bonds retired	77,510	6,335	17,070	71,175	(10,735)
Total expenditures	138,929	68,055	79,600	70,874	(11,545)
Net change in fund balances	(1,261)	(244)	25	(1,017)	(269)
Fund balance, beginning of year	116,796	117,040	117,015	(244)	25
Fund balance, end of year	$ 115,535	$ 116,796	$ 117,040	$ (1,261)	$ (244)

TSRs recorded in the DSF for fiscal years 2016, 2015 and 2014 were based on the amount collected each year to pay debt service obligations, pursuant to the Indenture. The large increase in the 2016 TSRs was due to the settlement agreement, as previously discussed. The variances of investment earnings in fiscal years 2016, 2015 and 2014 were primarily due to market value fluctuations of long-term investments.

Interest expenditures were lower in fiscal years 2016, 2015 and 2014 because the declining amount of bond principal outstanding resulted in reduced bond interest costs each year. Principal payments on bonds are based on the turbo redemption (see Note 1) terms of the Indenture. The large increase in the 2016 principal retired was due to the settlement agreement, as previously discussed.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS (continued)

The following summarizes GF assets, liabilities, deferred inflows of resources, and fund balances as of June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
		--------in thousands------		--------in thousands------	
Assets:					
Cash equivalents and investments	$ 556	$ 632	$ 654	$ (76)	$ (22)
Tobacco settlement revenue receivable	48,202	46,324	46,950	1,878	(626)
Prepaid expenditures	164	167	167	(3)	-
Total assets	$ 48,922	$ 47,123	$ 47,771	$ 1,799	$ (648)
Liabilities:	$ 12	$ 22	$ 21	$ (10)	$ 1
Deferred Inflows of Resources	48,202	46,324	46,950	1,878	(626)
Fund Balances:					
Nonspendable prepaid expenditures	164	167	167	(3)	-
Unassigned	544	610	633	(66)	(23)
Total fund balances	708	777	800	(69)	(23)
Total liabilities, deferred inflows of resources and fund balances	$ 48,922	$ 47,123	$ 47,771	$ 1,799	$ (648)

The GF assets at June 30, 2016, 2015 and 2014, totaled approximately $48.9 million, $47.1 million and $47.8 million, respectively. The slight variances of total assets in fiscal years 2016, 2015 and 2014 were primarily due to the change of estimated TSRs receivable, which is based on current years TSRs collections, as previously discussed. As the majority of the assets recorded in the GF are TSRs receivable belonging to the Trust, which are also recorded as deferred inflows of resources, there is little net impact on the GF fund balance.

Prepaid expenditures represent the value of prepaid insurance.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FUNDS FINANCIAL STATEMENTS (continued)

The following summarizes the DSF assets, liabilities, deferred inflows of resources, and fund balances as of June 30,

	2016	2015	2014	Variance 2016/2015	Variance 2015/2014
		--------in thousands------		--------in thousands------	
Assets:					
Cash equivalents and investments	$ 115,535	$ 116,796	$ 117,040	$ (1,261)	$ (244)
Tobacco settlement revenue receivable	28,798	27,676	28,050	1,122	(374)
Total assets	$ 144,333	$ 144,472	$ 145,090	$ (139)	$ (618)
Deferred Inflows of Resources:	$ 28,798	$ 27,676	$ 28,050	$ 1,122	$ (374)
Fund Balances:					
Restricted for debt service	115,535	116,796	117,040	(1,261)	(244)
Total fund balances	115,535	116,796	117,040	(1,261)	(244)
Total deferred inflows of resources and fund balances	$ 144,333	$ 144,472	$ 145,090	$ (139)	$ (618)

The fluctuations of assets and deferred inflows of resources from year to year are primarily due to changes in TSRs receivable and market value fluctuations of long-term investments, as previously discussed.

During the years reported herein, the rating agencies maintaining credit ratings on TSASC issued one or more rating changes to TSASC's outstanding debt. Currently, Standard & Poor's rates TSASC's 2022 term bonds BBB-, the 2026 term bonds BB-, the 2034 term bonds B, and the 2042 term bonds B-. On June 15, 2016, Fitch Ratings withdrew all ratings assigned on U.S. tobacco settlement asset-backed securities primarily because modifications to calculations under the MSA have eroded Fitch's confidence that ratings can be consistently maintained.

This financial report is designed to provide a general overview of TSASC's finances. Questions concerning any of the information in this report or requests for additional financial information should be directed to Investor Relations, TSASC, Inc., 255 Greenwich Street, New York, NY 10007.

** * **

TSASC, INC.
(A Component Unit of The City of New York)

STATEMENTS OF NET POSITION (DEFICIT)

AS OF JUNE 30, 2016 AND 2015

	2016	2015
	(in thousands)	
ASSETS:		
Unrestricted cash equivalents	$ 204	$ 216
Restricted cash equivalents	314	5,223
Unrestricted investments	352	416
Restricted investments	115,221	111,573
Tobacco settlement revenue receivable	77,000	74,000
Prepaid expenses	164	167
Total assets	193,255	191,595
LIABILITIES:		
Accrued expenses	12	22
Accrued interest payable	4,811	5,118
Remittance payable to the Trust	48,202	46,324
Bonds payable	1,120,606	1,196,869
Total liabilities	1,173,631	1,248,333
NET POSITION (DEFICIT):		
Unrestricted (deficit)	(980,376)	(1,056,738)
Total net position (deficit)	$ (980,376)	$ (1,056,738)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
	(in thousands)	
REVENUES:		
Tobacco settlement revenue:		
Tobacco settlement revenue - pledged	$ 137,925	$ 67,355
Tobacco settlement revenue - unpledged	230,858	112,739
Total tobacco settlement revenue	368,783	180,094
Investment earnings	1,271	503
Total revenues	370,054	180,597
EXPENSES:		
Transfer to the Trust	230,910	112,743
Interest expense	62,359	63,002
General and administrative	423	440
Total expenses	293,692	176,185
Change in net position	76,362	4,412
NET POSITION (DEFICIT) - beginning of year	(1,056,738)	(1,061,150)
NET POSITION (DEFICIT) - end of year	$ (980,376)	$ (1,056,738)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.
(A Component Unit of The City of New York)

GOVERNMENTAL FUNDS BALANCE SHEETS

AS OF JUNE 30, 2016

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS:			
Unrestricted cash equivalents	$ 204	$ -	$ 204
Restricted cash equivalents	-	314	314
Unrestricted investments	352	-	352
Restricted investments	-	115,221	115,221
Tobacco settlement revenue receivable	48,202	28,798	77,000
Prepaid expenditures	164	-	164
Total assets	$ 48,922	$ 144,333	$ 193,255
LIABILITIES:			
Accounts payable	$ 12	$ -	$ 12
Total liabilities	12	-	12
DEFERRED INFLOWS OF RESOURCES:			
Unavailable tobacco settlement revenue	48,202	28,798	77,000
Total deferred inflows of resources	48,202	28,798	77,000
FUND BALANCES:			
Nonspendable prepaid expenditures	164	-	164
Restricted for debt service	-	115,535	115,535
Unassigned	544	-	544
Total fund balances	708	115,535	116,243
Total liabilities, deferred inflows of resources and fund balances	$ 48,922	$ 144,333	$ 193,255

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

GOVERNMENTAL FUNDS BALANCE SHEETS

AS OF JUNE 30, 2015

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS:			
Unrestricted cash equivalents	$ 216	$ -	$ 216
Restricted cash equivalents	-	5,223	5,223
Unrestricted investments	416	-	416
Restricted investments	-	111,573	111,573
Tobacco settlement revenue receivable	46,324	27,676	74,000
Prepaid expenditures	167	-	167
Total assets	$ 47,123	$ 144,472	$ 191,595
LIABILITIES:			
Accounts payable	$ 22	$ -	$ 22
Total liabilities	22	-	22
DEFERRED INFLOWS OF RESOURCES:			
Unavailable tobacco settlement revenue	46,324	27,676	74,000
Total deferred inflows of resources	46,324	27,676	74,000
FUND BALANCES:			
Nonspendable prepaid expenditures	167	-	167
Restricted for debt service	-	116,796	116,796
Unassigned	610	-	610
Total fund balances	777	116,796	117,573
Total liabilities, deferred inflows of resources and fund balances	$ 47,123	$ 144,472	$ 191,595

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

RECONCILIATIONS OF GOVERNMENTAL FUNDS BALANCE SHEETS TO THE STATEMENTS OF NET POSITION (DEFICIT)

AS OF JUNE 30, 2016 AND 2015

	2016	2015
	(in thousands)	
Total fund balances - governmental funds	$ 116,243	$ 117,573
Amounts reported for governmental activities in the statements of net position (deficit) are different because:		
Bond discounts are reported as other financing uses in the governmental funds financial statements upon issuance. However, in the statements of net position (deficit), bond discounts are reported as a component of bonds payable and amortized over the life of the bonds.	23,919	25,166
Unavailable tobacco settlement revenue accrued but not received within two months after year end is reported as a deferred inflows of resources in the governmental funds financial statements because it's not currently available; however, it is recognized as revenue in the statements of net position (deficit).	77,000	74,000
Liabilities not due and not payable in the current period from current financial resources are not reported in the governmental funds financial statements, but are reported in the statements of net position (deficit). Those liabilities consist of:		
Bonds payable	(1,144,525)	(1,222,035)
Accrued interest payable	(4,811)	(5,118)
Remittance payable to the Trust	(48,202)	(46,324)
Net position (deficit) of governmental activities	$ (980,376)	$ (1,056,738)

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

GOVERNMENTAL FUNDS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

FOR THE YEAR ENDED JUNE 30, 2016

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Tobacco settlement revenue:			
Tobacco settlement revenue - pledged	$ 352	$ 136,451	$ 136,803
Tobacco settlement revenue - unpledged	228,980	-	228,980
Total tobacco settlement revenue	229,332	136,451	365,783
Investment earnings	54	1,217	1,271
Total revenues	229,386	137,668	367,054
EXPENDITURES:			
Transfer to the Trust:			
Tobacco settlement revenue and interest earnings	229,032	-	229,032
Interest expenditure	-	61,419	61,419
Principal amount of bonds retired	-	77,510	77,510
General and administrative	423	-	423
Total expenditures	229,455	138,929	368,384
Net change in fund balances	(69)	(1,261)	(1,330)
FUND BALANCES - beginning of year	777	116,796	117,573
FUND BALANCES - end of year	$ 708	$ 115,535	$ 116,243

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

GOVERNMENTAL FUNDS

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

FOR THE YEAR ENDED JUNE 30, 2015

	(in thousands)		
	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Tobacco settlement revenue:			
Tobacco settlement revenue - pledged	$ 416	$ 67,313	$ 67,729
Tobacco settlement revenue - unpledged	113,365	-	113,365
Total tobacco settlement revenue	113,781	67,313	181,094
Investment earnings	5	498	503
Total revenues	113,786	67,811	181,597
EXPENDITURES:			
Transfer to the Trust:			
Tobacco settlement revenue and interest earnings	113,369	-	113,369
Interest expenditure	-	61,720	61,720
Principal amount of bonds retired	-	6,335	6,335
General and administrative	440	-	440
Total expenditures	113,809	68,055	181,864
Net change in fund balances	(23)	(244)	(267)
FUND BALANCES - beginning of year	800	117,040	117,840
FUND BALANCES - end of year	$ 777	$ 116,796	$ 117,573

The accompanying notes are an integral part of these financial statements.

TSASC, INC.

(A Component Unit of The City of New York)

RECONCILIATIONS OF THE GOVERNMENTAL FUNDS STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES TO THE STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	2016	2015
	(in thousands)	
Net change in fund balances - governmental funds	$ (1,330)	$ (267)
Amounts reported for governmental activities in the statements of activities are different because:		
Tobacco settlement revenue not available in the current period is deferred in governmental funds financial statements and included in revenue in the statements of activities.	3,000	(1,000)
Repayment of bond principal is an expenditure in the governmental funds financial statements, but the repayment reduces bonds payable on the statements of net position (deficit).	77,510	6,335
The governmental funds financial statements report bond discounts as other financing uses upon issuance. However, on the statements of activities, bond discounts are amortized to interest expense over the life of the bond.	(1,247)	(1,307)
Interest is reported on the statements of activities on the accrual basis. However, interest is reported as an expenditure in the governmental funds financial statements when the outlay of financial resources is paid.	307	25
Transfer to the Trust is reported in the statements of activities on the accrual basis, but is reported only as an expenditure in the general fund when the payment is actually made.	(1,878)	626
Change in net position (deficit) - governmental activities	$ 76,362	$ 4,412

The accompanying notes are an integral part of these financial statements.

NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

TSASC, Inc. ("TSASC") is a special purpose, local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the "State"). TSASC is an instrumentality of, but separate and apart from, The City of New York (the "City"). TSASC is governed by a Board of five directors, consisting of the following officials of the City: the Director of Management and Budget, the Commissioner of Finance, the Corporation Counsel of the City, the Comptroller and the Speaker of the Council. Although legally separate from the City, TSASC is a component unit of the City and is included in the City's financial statements as a blended component unit in accordance with Governmental Accounting Standards Board ("GASB") standards.

Pursuant to a Purchase and Sale Agreement with the City, the City sold to TSASC all of its future right, title and interest in the Tobacco Settlement Revenues ("TSRs") under the Master Settlement Agreement ("MSA") and the Decree and Final Judgment (the "Decree"). The MSA resolved cigarette smoking-related litigation between the settling States and the Participating Manufacturers ("PMs"), released the PMs from past and present smoking-related claims, and provided for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the settling States, as well as certain tobacco advertising and marketing restrictions, among other things. The Decree, which was entered by the Supreme Court of the State, allocated to the City a share of the TSRs under the MSA. The future right, title and interest of the City to the TSRs were sold to TSASC.

The purchase price of the City's future right, title and interest in the TSRs was financed by the issuance of a series of bonds and the Residual Certificate. Prior to the restructuring of TSASC's debt (discussed below) the Residual Certificate represented the entitlement to receive all TSRs after payment of debt service, operating expenses and certain other costs as set forth in the original bond indenture.

Under the *Amended and Restated Indenture* dated January 1, 2006 (the "Indenture"), the Residual Certificate represents the entitlement to receive all amounts in excess of specified percentages of TSRs and other revenues (collectively, "Collections") used to fund debt service and operating expenses of TSASC. The Collections in excess of the specified percentages will be transferred to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate and then to the City as the beneficial owner of the Trust. The Indenture allows transfers to the Trust after December 6, 2007.

The Indenture provides that a specified percentage of collections are pledged ("Pledged") and required to be applied to the payment of debt service and operating costs. The Pledged collections percentage is 37.4% and is subject to reduction on June 1, 2024, and at each June 1st thereafter, depending on the magnitude of cumulative bond redemptions under the turbo redemption feature ("turbo") of the Series 2006-1 bonds. The turbo requires all Pledged Collections, after payment of operating costs, to be applied to payment of principal and interest on the Series 2006-1 bonds.

TSASC does not have any employees; its affairs are administered by employees of the City and of another component unit of the City, for which TSASC pays a management fee, rent and overhead based on its allocated share of personnel and overhead costs.

The government-wide financial statements of TSASC, which include the statements of net position (deficit) and the statements of activities, are presented to display information about the reporting entity as a whole, in accordance with GASB standards. The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

TSASC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting, in which revenue is recognized when it becomes susceptible to accrual; that is, when it becomes both measurable and available to finance expenditures in the current fiscal period. Expenditures are recognized when the related liability is incurred, except for principal and interest on bonds payable, which are recognized when due.

TSASC uses two governmental funds for reporting its activities: a debt service fund ("DSF") and a general fund ("GF"). The DSF is used to account for the accumulation of resources for payment of principal and interest on debt and the GF is used to account for all financial resources not accounted for in the DSF, which are TSASC's unpledged TSRs due to the City, and administrative and operating expenditures. Fund balances are classified as either: 1) nonspendable, 2) restricted, 3) committed, 4) assigned, or 5) unassigned in accordance with GASB standards.

The Board of Directors of TSASC (the "Board") constitutes TSASC's highest level of decision-making authority. If and when resolutions are adopted by the Board that constrain fund balances for a specific purpose, such resources are accounted for and reported as committed for such purpose; unless and until a subsequent resolution altering the commitment is adopted by the Board.

If and when fund balances which are constrained for use for a specific purpose, based on the direction of any officer of TSASC who is duly authorized under TSASC's bond indenture to direct the movement of such funds, are accounted for and reported as assigned for such purpose unless and until a subsequent authorized action by the same or another duly authorized officer, or by the Board, is taken which removes or changes the assignment.

When both restricted and unrestricted resources are available for use for a specific purpose, it is TSASC's policy to use restricted resources first then unrestricted resources as they are needed. When committed, assigned, or unassigned resources are available for use for a specific purpose, it is TSASC's policy to use committed resources first, then assigned resources, and then unassigned resources as they are needed.

Investments are reported at fair value as of the reporting date.

TSASC records TSRs receivable at June 30th. The TSRs receivable is expected to be received the following April of each year and is based on an estimate of cigarette sales for the six month period from January 1 to June 30. As it is not expected to be received within two months of the fiscal year end, the unavailable revenue related to the TSRs receivable is deferred in the governmental funds financial statements. Per the Indenture, 62.6% of TSRs receivable is due to the Trust. As such, a concurring payable is recorded in the government-wide financial statements.

Bond discounts are amortized over the life of the related debt using the interest method in the government-wide financial statements. The governmental funds financial statements recognize bond discounts, as well as bond issuance costs, during the current period. Bond issuance costs are recognized as an expense/expenditure in the period incurred in the government-wide and governmental funds financial statements, respectively. The amounts of unamortized bond discount at June 30, 2016 and 2015 were $23.9 million and $25.2 million, respectively, which were net of accumulated amortization of $14.6 million and $13.4 million, respectively.

Interest expense is recognized on the accrual basis in the government-wide financial statements. Interest expenditures are recognized when paid in the governmental funds financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires TSASC's management to make estimates and assumptions in determining the reported amounts of assets, deferred outflows of resources, liabilities, and deferred inflows of resources as of the date of the financial statements and the amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

As a component unit of the City, TSASC implements new GASB standards in the same fiscal year as they are implemented by the City. The following are discussions of the standards requiring implementation in the current year and standards which may impact TSASC in the future years.

- In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pension and Related Assets That Are Not within the Scope of GASB 68, and Amendments to Certain Provision of GASB 67 and GASB 68* ("GASB 73"). GASB 73 provides guidance on assets accumulated for pension plans that are not administered through a trust and provides clarity on certain provision of GASB 67 and GASB 68. The requirements for GASB 73 are effective for fiscal years beginning after June 15, 2015. The adoption of GASB 73 did not have an impact on TSASC's financial statements.

- In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* ("GASB 74"). GASB 74 establishes financial reporting standards to state and local governmental other postemployment benefit ("OPEB") plans. The requirements of GASB 74 are effective for fiscal years beginning after June 15, 2016. TSASC has not completed the process of evaluating GASB 74, but does not expect it to have an impact on TSASC's financial statements as it has no employees.

- In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("GASB 75"). GASB 75 establishes accounting and financial reporting standards for OPEB that is provided to employees of state and local governmental employees. The requirements of GASB 75 are effective for fiscal years beginning after June 15, 2017. TSASC has not completed the process of evaluating GASB 75, but does not expect it to have an impact on TSASC's financial statements as it has no employees.

- In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* ("GASB 76"). GASB 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction of other event is not specified within the source of authoritative GAAP. The requirements of GASB 76 are effective for fiscal years beginning after June 15, 2015. The adoption of GASB 76 did not have an impact on TSASC's financial statements.

- In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures* ("GASB 77"). GASB 77 requires state and local governments for the first time to disclose information about tax abatement agreements. GASB 77 requires governments to disclose information about their own tax abatements separately from information about tax abatements that are entered into by other governments and reduce the reporting government's tax revenues. The requirements of GASB 77 are effective for fiscal years beginning after December 15, 2015. The adoption of GASB 77 did not have an impact on TSASC's financial statements as it does not enter into any such agreements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- In December 2015, GASB issued Statement No. 78, *Pensions Provided Through Certain Multiple-Employer Defined Benefit Pension Plans* ("GASB 78"). GASB 78 amends the scope and applicability of Statement 68 to exclude pension plans provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local government pension plan, (2) is used to provide defined benefits both to employees of state or local governmental employers and to employees of employers that are not state or local governments, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pension through the pension plan). The requirements of GASB 78 are effective for fiscal years beginning after December 15, 2015. The adoption of GASB 78 did not have an impact on TSASC's financial statements as it has no employees.

- In December 2015, GASB issued Statement No 79, *Certain External Investment Pools and Pool Participants* ("GASB 79"). GASB 79 will enhance comparability of financial statements among governments by establishing specific criteria used to determine whether a qualifying external investment pool may elect to use an amortized cost exception to fair value measurement. Those criteria will provide qualifying external investment pools and participants in those pools with consistent application of an amortized cost-based measurement for financial reporting purposes. That measurement approximates fair value and mirrors the operations of external investment pools that transact with participants at a stable net asset value per share. The requirements of GASB 79 are effective for fiscal years beginning after December 15, 2015. The adoption of GASB 79 did not have an impact on TSASC's financial statements as it has no such investments.

- In January 2016, GASB issued Statement No 80, *Blending Requirements for Certain Component Units* ("GASB 80"). GASB 80 provides clarity on how certain component units incorporated as not-for-profit corporations should be presented in the financial statements of the primary state or local government. The requirements of GASB 80 are effective for fiscal years beginning after June 15, 2016. The adoption of GASB 80 did not have an impact on TSASC's financial statements.

- In March 2016, GASB issued Statement No 81, *Irrevocable Split Interest Agreements* ("GASB 81"). GASB 81 addresses the situations under which an irrevocable split-interest agreement constitutes an asset for accounting and financial reporting purposes when the resources are administered by a third party. GASB 81 also provides expanded guidance for circumstances in which the government holds the assets. The requirements of GASB 81 are effective for fiscal years beginning after December 15, 2016. The adoption of GASB 81 did not have an impact on TSASC's financial statements as it does not enter in such arrangements.

- In March 2016, GASB issued Statement No 82, *Pension Issues* ("GASB 82"). GASB 82 addresses practice issues raised during the implementation of the GASB's pension accounting and financial reporting standards for state and local governments. The requirements of GASB 82 are effective for fiscal years beginning after June 15, 2016. The adoption of GASB 82 did not have an impact on TSASC's financial statements as it has no employees.

NOTE 3 – BONDS PAYABLE

In accordance with the Indenture, Pledged Collections were used to fund operating expenses; then to fund interest payments due; and then to fund and make turbo redemption payments. During fiscal years 2016 and 2015, turbo redemptions were $77.5 million and $6.3 million, respectively.

Outstanding bonds payable bear interest at rates ranging from 4.750% to 5.125%. A summary of changes in outstanding bonds in fiscal years 2016 and 2015 is as follows (in thousands):

	Outstanding Principal Balance at June 30, 2014	Additions	Deletions	Outstanding Principal Balance at June 30, 2015	Additions	Deletions	Outstanding Principal Balance at June 30, 2016
Series 2006-1	$ 1,228,370	$ -	$ (6,335)	$ 1,222,035	$ -	$ (77,510)	$ 1,144,525
Total before discounts (net)	1,228,370	-	(6,335)	1,222,035	-	(77,510)	1,144,525
Less discounts (net)	(26,473)	-	1,307	(25,166)	-	1,247	(23,919)
Total Bonds Payable and Discount	$ 1,201,897	$ -	$ (5,028)	$ 1,196,869	$ -	$ (76,263)	$ 1,120,606

Term bond maturities for these bonds represent the minimum amount of principal that TSASC must pay as of the specific distribution dates in order to avoid a default. The sinking fund principal payments represent the amount of principal that TSASC expects to pay from the pledged TSRs collected. If pledged TSRs collected exceed the principal and interest required under the term bond maturities, then the excess will be applied first to the sinking fund payment and then to turbo redemptions. Turbo redemption payments will be credited against both sinking fund installments and the term bond maturities in chronological order.

Debt service requirements for term bond maturities and anticipated sinking fund principal payments, including principal and interest as of June 30, 2016 are as follows (in thousands):

	Term Bond Maturities			Sinking Fund Principal Payments		
	Principal	Interest	Total	Principal	Interest	Total
Year ended June 30,						
2017	$ -	$ 57,737	$ 57,737	$ -	$ 57,737	$ 57,737
2018	-	57,737	57,737	-	57,737	57,737
2019	-	57,737	57,737	-	57,737	57,737
2020	-	57,737	57,737	27,440	57,737	85,177
2021	-	57,737	57,737	28,965	56,434	85,399
2022 to 2026	212,850	274,420	487,270	156,445	261,844	418,289
2027 to 2031	-	236,413	236,413	215,865	215,905	431,770
2032 to 2036	372,650	199,148	571,798	275,800	156,224	432,024
2037 to 2041	-	143,250	143,250	356,835	78,094	434,929
2042	559,025	28,650	587,675	83,175	4,263	87,438
	$ 1,144,525	$ 1,170,566	$ 2,315,091	$ 1,144,525	$ 1,003,712	$ 2,148,237

NOTE 3 – BONDS PAYABLE (continued)

As of June 30, 2016 and 2015, TSASC has funded its debt service and reserve accounts according to the Indenture requirements. As of June 30, 2016 and 2015, debt service accounts holdings totaled $28.9 million and $30.7 million, respectively. As of June 30, 2016 and 2015, the TSASC Liquidity Reserve Account balances were $86.7 million and $86.1 million, respectively, and in compliance with the Indenture.

NOTE 4 – CASH EQUIVALENTS

TSASC's cash equivalents consist of money market funds. As of June 30, 2016 and 2015, total cash equivalents are summarized as follows:

	2016	2015
	(in thousands)	
Restricted:		
Cash equivalents (see note 5)	$ 314	$ 5,223
Total restricted	314	5,223
Unrestricted:		
Cash equivalents (see note 5)	$ 204	$ 216
Total unrestricted	204	216
Total cash equivalents	$ 518	$ 5,439

NOTE 5 – INVESTMENTS

The investments, including cash equivalents, as of June 30, 2016 and 2015 are summarized as follows:

	2016	2015
	(in thousands)	
Restricted:		
Money Market Funds	$ 314	$ 5,223
United States Treasury notes (Maturing within one year)	68,952	-
Fannie Mae discount notes (Maturing within one year)	28,880	-
Federal Home Loan Bank discount notes (Maturing within one year)	-	30,704
Federal Home Loan Bank term bonds (Maturing within one year)	-	63,969
Municipal Bonds--various states (Maturing over five years)	17,389	16,900
Total restricted	115,535	116,796
Unrestricted:		
Money Market Funds	204	216
Fannie Mae discount notes (Maturing within one year)	352	-
Federal Home Loan Mortage Corp discount notes (Maturing within one year)	-	416
Total unrestricted	556	632
Total investments including cash equivalents	116,091	117,428
Less amounts reported as cash equivalents (see note 4)	(518)	(5,439)
Total investments	$ 115,573	$ 111,989

TSASC categorizes its fair value measurements within the fair value hierarchy established by U.S. GAAP. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs. TSASC had the following recurring fair value measurements as of June 30, 2016 and 2015:

- Money Market Funds are valued based on various market and industry inputs (Level 2 inputs).
- U.S. Agency securities are valued using a matrix pricing model (Level 2 inputs).
- Municipal bonds are valued using a matrix pricing model (Level 2 inputs)

Each account of TSASC is held pursuant to the Indenture between TSASC and its Trustee and may be invested in securities or categories of investments that are specifically enumerated as permitted investments for such account pursuant to the Indenture.

NOTE 5 – INVESTMENTS (continued)

Custodial credit risk: Is the risk that, in the event of the failure of the custodian, TSASC may not be able to recover the value of its investments that are in the possession of an outside party. TSASC's investments are not collateralized. All investments are held in the Trustee's name by the Trustee.

Credit risk: All investments held by TSASC at June 30, 2016 are securities invested as follows: state general obligations of Utah, Georgia and Texas rated by Moody's Aaa, S&P AAA and Fitch AAA; state general obligations of Nevada rated by Moody's Aa2, S&P AA and Fitch AA+; securities in Fannie Mae discount notes and United States Treasury notes rated by Moody's P-1 and S&P A-1+; securities in Fannie Mae discount notes and United States Treasury notes rated by Moody's Aaa and S&P AA+.

Interest rate risk: TSASC's investments mature in less than one year, unless otherwise specified above. Investments with longer term maturities are not expected to be liquidated prior to maturity, thereby limiting exposure from rising interest rates.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of TSASC's investment in a single issuer (5% or more). TSASC's investment policy places no limit on the amount TSASC may invest in any one issuer of eligible government obligations as defined in the Indenture. As of June 30, 2016, more than 5% of TSASC's investments were in U.S. Government-sponsored entities and Utah State general obligation bonds. These investments are 84.6% and 6.7% of TSASC's total investments, respectively.

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APPENDIX F

BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company, New York, New York ("**DTC**") will act as securities depository for the Series 2017 Bonds (the "**Securities**"). The Securities 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 each principal amount of Securities of each series, maturing on a specific date and bearing interest at a specific interest rate, each in the aggregate principal amount of such quantity of Security, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**"). 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 Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC's records. The ownership interest of each actual purchaser of each Security ("**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 Securities 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 Securities, except in the event that use of the book-entry system for the Securities is discontinued.

To facilitate subsequent transfers, all Securities 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 Securities 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 Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities 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 Securities may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee

holding the Securities for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Securities unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to TSASC 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 Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payment of redemption proceeds and principal and interest on the Securities 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 TSASC or the Indenture Trustee on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Indenture Trustee or TSASC, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds and principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of TSASC or the Indenture Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to TSASC or the Indenture Trustee. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.

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

TSASC AND THE INDENTURE TRUSTEE CANNOT AND DO NOT GIVE ANY ASSURANCES THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS WILL DISTRIBUTE TO THE BENEFICIAL OWNERS OF THE SECURITIES: (1) PAYMENTS OF PRINCIPAL OF OR INTEREST OR REDEMPTION PREMIUM ON THE SECURITIES; (2) CONFIRMATIONS OF THEIR OWNERSHIP INTERESTS IN THE SECURITIES; OR (3) OTHER NOTICES SENT TO DTC OR CEDE & CO., ITS PARTNERSHIP NOMINEE, AS THE REGISTERED OWNER OF THE SECURITIES, OR THAT THEY WILL DO SO ON A TIMELY BASIS, OR THAT DTC OR DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS WILL SERVE AND ACT IN THE MANNER DESCRIBED IN THIS OFFERING CIRCULAR.

TSASC AND THE INDENTURE TRUSTEE WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO DTC, DIRECT PARTICIPANTS, INDIRECT PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS; (2) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OF OR INTEREST OR REDEMPTION PREMIUM ON THE SECURITIES; (3) THE DELIVERY BY DTC, ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF ANY NOTICE TO ANY BENEFICIAL OWNER THAT IS REQUIRED OR PERMITTED TO BE GIVEN TO OWNERS UNDER THE TERMS OF THE INDENTURE; OR (4) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE REGISTERED HOLDER OF THE SECURITIES.

THE INFORMATION CONTAINED HEREIN CONCERNING DTC AND ITS BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM DTC, AND NEITHER TSASC NOR THE UNDERWRITERS MAKE

ANY REPRESENTATION AS TO THE COMPLETENESS OR THE ACCURACY OF SUCH INFORMATION OR AS TO THE ABSENCE OF MATERIAL ADVERSE CHANGES IN SUCH INFORMATION SUBSEQUENT TO THE DATE HEREOF.

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APPENDIX G

PROPOSED FORM OF OPINION OF TRANSACTION COUNSEL

November __, 2016

TSASC, Inc.
255 Greenwich Street, Seventh Floor
New York, New York 10007

Re: TSASC, Inc.
$_____ Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior)
$_____ Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate)

Ladies and Gentlemen:

We have acted as transaction counsel to TSASC, Inc. (the "Corporation") in connection with the issuance of $_____ aggregate principal amount of Tobacco Settlement Bonds, consisting of $_____ aggregate principal amount of Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior) and $_____ aggregate principal amount of Tobacco Settlement Bonds, Fiscal 2017 Series B (Subordinate) (together, the "Bonds"), pursuant to an Amended and Restated Indenture, dated as of _____ 1, 2016 (the "Indenture"), by and between the Corporation and The Bank of New York Mellon, as Trustee. Capitalized terms used but not defined herein shall have the meanings given to them in the Indenture.

In such connection, we have reviewed executed copies of the Indenture, the Purchase and Sale Agreement dated November 18, 1999, as amended (the "Agreement"), between the Corporation and The City of New York (the "City"), the Tax Certificates of the Corporation and the City dated the date hereof (the "Tax Certificates"), the Bonds, certificates of the Corporation, the City and others and such other documents, opinions, and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Corporation. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Agreement and the Tax Certificates, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Agreement and the Tax Certificates and their enforceability may be subject to bankruptcy, insolvency, receivership, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against not-for-profit corporations such as the Corporation in the State of New York. We express no opinion with respect to any indemnification,

contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the remedies available to enforce liens on any of the assets described in or subject to the lien of the Indenture or the Agreement. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Circular or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Corporation.

2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Corporation. The Indenture creates a valid pledge of and security interest in, to secure the payment of the principal of and interest on the Bonds, the Collateral which includes, among other things, the Pledged TSRs and any other amounts (including proceeds of the sale of the Bonds) held by the Trustee in the Pledged Accounts established pursuant to the Indenture, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture. All action has been taken as is necessary to perfect such pledge and security interest in the Pledged TSRs as such pledge and security interest exists on the date hereof and such perfected pledge and security interest constitutes a first priority pledge and security interest.

3. The Agreement has been duly executed and delivered by, and constitutes a valid and binding agreement of, the Corporation.

4. The Corporation has validly included in the Indenture the pledge and agreement of the City with the Owners of the Outstanding Bonds that the City will not limit or alter the rights of the Corporation to fulfill the terms of its agreements with such Owners, or in any way impair the rights and remedies of such Owners or the security for such Bonds until such Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Owners, are fully paid and discharged.

5. The Bonds are not a lien or charge upon the funds or property of the Corporation except to the extent of the aforementioned pledge and security interest. Neither the faith and credit, the revenues nor the taxing power of the State of New York or of any political subdivision thereof (including the City) is or shall be deemed to be pledged to the payment of the principal of or interest on the Bonds. The Bonds are not a debt of the State of New York or the City, and said State and said City are not liable for the payment thereof.

6. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings in calculating corporate alternative minimum taxable income. Interest on the Bonds is exempt from personal income taxes imposed by the State of New York and any political subdivision thereof (including the City). We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

APPENDIX H

FORM OF CONTINUING DISCLOSURE UNDERTAKING

TSASC, Inc.
Tobacco Settlement Bonds,
Fiscal 2017 Series A (Senior) and Fiscal 2017 Series B (Subordinate)
CONTINUING DISCLOSURE UNDERTAKING

To the extent that Rule 15c2-12 (the "Rule") of the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "1934 Act"), requires the respective underwriters (as defined in the Rule) of TSASC, Inc.'s Tobacco Settlement Bonds, Fiscal 2017 Series A (Senior) and Fiscal 2017 Series B (Subordinate) (collectively, the "Bonds") to determine, as a condition to purchasing the Bonds, that TSASC, Inc. (the "Corporation") will covenant to the effect of this undertaking (the "Undertaking"), and the Rule as so applied is authorized by a Federal law that as so construed is within the powers of Congress, the Corporation agrees with the record and beneficial owners from time to time of the outstanding Bonds (the "Bondholders") that:

1. The Corporation shall provide to the Municipal Securities Rulemaking Board (the "MSRB") established pursuant to Section 15B(b)(1) of the 1934 Act, or any successor thereto or to the functions of the MSRB, the following:

(a) within nine calendar months after the end of each fiscal year:

(i) The Corporation's audited financial statements for the prior fiscal year, prepared in accordance with generally accepted accounting principles in effect from time to time;

(ii) the total amount of Collections received by the Corporation during the prior fiscal year; and

(iii) the total amount of Collections deposited in the Operating Account during the prior fiscal year (regardless of the fiscal year in which Operating Expenses are to be paid); and

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

(i) principal and interest payment delinquencies;

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

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

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

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

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

(vii) modifications to rights of Owners, if material;

(viii) Bond calls, if material, and tender offers;

(ix) defeasances;

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

(xi) rating changes;

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

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

(xiv) appointment of a successor or additional Trustee or the change of name of a Trustee, if material; and

(c) in a timely manner, notice of a failure by the Corporation to comply with the obligation to provide the information specified in clause (a) above; and

(d) With respect to events listed in clauses (b)(iv) and (v), the Corporation does not undertake to provide such notice with respect to credit enhancement if:

(i) the enhancement is added after the primary offering of the Bonds,

(ii) the Corporation does not apply for or participate in obtaining the enhancement; and

(iii) the enhancement is not described in the applicable official statement or offering circular of the Corporation; and

(e) With respect to events listed in clause in clause b(viii) the Corporation does not undertake to provide notice with respect to 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 in the Offering Circular,

(ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption,

(iii) notice of redemption is given to the Owners as required under the terms of the Indenture (as defined below) and

(iv) public notice of the redemption is given pursuant to Exchange Act Release No. 23856 of the SEC, even if the originally scheduled amounts may be reduced by prior optional redemptions or purchases; and

(f) With respect to events listed in clause in clause b(vi) the Corporation does not undertake to provide notice with respect to tax exemption other than pursuant to Section 103 of the Code; and

(g) The Corporation does not undertake to provide notice with respect to any forward-looking statements contained in the Offering Circular, including but not limited to those that include the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," or analogous expressions.

2. No Bondholder may institute any suit, action or proceeding at law or in equity ("Proceeding") for the enforcement of any covenant herein or for any remedy for breach thereof, unless (a) such Bondholder shall have filed with the Corporation evidence of beneficial ownership and written notice of, and request to cure, the alleged breach, (b) the Corporation shall have failed to comply within a reasonable time and (c) such beneficial owner stipulates that (A) no challenge is made to the adequacy of any information provided in accordance with this Undertaking and (B) no remedy is sought other than specific performance of this Undertaking. All Proceedings shall be instituted only as specified herein, in the Federal or State courts located in the Borough of Manhattan, State and City of New York, and for the equal benefit of all holders of the outstanding bonds benefited by the same or a substantially similar covenant, and no remedy shall be sought or granted other than specific performance of the covenant at issue.

3. An amendment to this Undertaking may only take effect if:

(a) 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 Corporation, or type of business conducted; this Undertaking, as amended, would have complied with the requirements of the Rule at the time of issuance of the 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 Owners, as determined by parties unaffiliated with the Corporation (such as, but without limitation, the Corporation's financial advisor or bond counsel); and the annual financial information containing (if applicable) the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the "impact" (as that word is used in the letter from the SEC staff to the National Association of Bond Lawyers dated June 23, 1995) of the change in the type of operating data or financial information being provided; or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date hereof, ceases to be in effect for any reason, and the Corporation elects that this Undertaking shall be deemed terminated or amended (as the case may be) accordingly.

4. (a) For the purposes of this 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, except that a person who in the ordinary course of business is a pledgee of securities under a written pledge agreement shall not be deemed to be the beneficial owner of such pledged securities until the pledgee has taken all formal steps to declare a default and determines that the power to dispose or to direct the disposition of such pledged securities will be exercised, provided that:

(i) the pledge agreement is bona fide;

(ii) the pledgee is:

(A) a broker or dealer registered under Section 15 of the 1934 Act;

(B) a bank as defined in section 3(a)(6) of the 1934 Act;

(C) an insurance company as defined in Section 3(a)(19) of the 1934 Act;

(D) an investment company registered under Section 8 of the Investment Company Act of 1940;

(E) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940;

(F) an employee benefit plan, or pension fund which is subject to the provisions of the Employee Retirement Income Security Act of 1974 or an endowment fund;

(G) a parent holding company, provided the aggregate amount held directly by the parent, and directly and indirectly by its subsidiaries which are not persons specified in items (A) through (F) of this clause (ii) does not exceed 1% of the securities of the subject class; or

(H) a group, provided that all the members are persons specified in items (A) through (G) of this clause (ii); and

(iii) the pledge agreement, prior to default, does not grant to the pledgee the power to dispose or direct the disposition of the pledged securities, other than the grant of such power(s) pursuant to a pledge agreement under which credit is extended subject to Regulation T (12 CFR 220.1 to 220.8) and in which the pledgee is a broker or dealer registered under Section 15 of the 1934 Act.

5. Unless otherwise required by the MSRB, any notices, documents and information provided to the MSRB pursuant to this Undertaking may be made solely by providing such filing to the MSRB's Electronic Municipal Market Access (EMMA) system, the current Internet Web address of which is www.emma.msrb.org. All notices, documents and information provided to the MSRB shall be provided in an electronic format as prescribed by the MSRB and shall be accompanied by identifying information as prescribed by the MSRB.

6. Terms not defined herein are used herein as they are used in the Amended and Restated Indenture (the "Indenture") pursuant to which the Bonds are issued, dated as of November 1, 2016, by and between the Corporation and the Trustee or the Rule.

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Dated: [_____], 2016

TSASC, Inc.

By: _____
Name:
Title: President

[Signature Page for Series 2017 Bonds Continuing Disclosure Undertaking]

APPENDIX I

DEFINITIONS AND SUMMARY OF THE INDENTURE

Set forth herein are definitions of certain terms and a summary of certain sections of the Indenture. These summaries do not purport to be complete and reference is made to the respective documents, copies of which are on file with the Trustee, for a complete statement of the rights, duties and obligations of the parties thereto. The headings herein are not part of the respective documents but have been added for ease of reference only.

DEFINED TERMS

The following are definitions of certain of the terms used in this Offering Circular and this Appendix (certain other terms are defined elsewhere in the text of the Offering Circular).

"**Accounts**" means the accounts established under the provisions of the Indenture.

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

"**Bond Purchase Agreement**" means the Bond Purchase Agreement by and among the Corporation and Jefferies LLC, as representative of the underwriters, relating to the sale of the Series 2017 Bonds, in such form as the parties thereto will agree.

"**Business Day**" means any day other than a Saturday, a Sunday, a day on which banking institutions in New York, New York are required or authorized by law to be closed or a day on which the New York Stock Exchange is closed.

"**Corporate Trust Office**" means the office of the Trustee at which the corporate trust business of the Trustee related to the Indenture will, at any particular time, be principally administered, which office is, at the date of the Indenture, located at 101 Barclay Street, New York, New York 10286.

"**Corporation**" means TSASC, Inc.

"**Counsel**" means nationally recognized bond counsel or such other counsel as may be selected by the Corporation for a specific purpose under the Indenture.

"**Debt Service Account(s)**" means the Senior Debt Service Account and the Subordinate Debt Service Account.

"**Defeasance Collateral**" means money and the following:

(i) U.S. Treasury obligations (direct or fully guaranteed), which are not redeemable at the option of the issuer thereof;

(ii) (a) direct obligations, the timely payment of the principal and interest on which are unconditionally guaranteed by the United States government; or (b) senior notes, bonds, debentures, mortgages and other evidences of indebtedness, issued or guaranteed at the time of the investment by Fannie Mae, FHLMC, the Federal Farm Credit System, FHLB, the Federal Housing Administration, the Resolution Funding Corporation

(REFCORP) or any other United States government sponsored agency; provided, that the above-listed investments are not redeemable at the option of the issuer thereof and which will be rated at the time of the investment no lower than investments defined under clause (i) by S&P;

(iii) any depositary receipt issued by an Eligible Bank as custodian with respect to any Defeasance Collateral which is specified in clause (i) 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 but only if such receipts are rated at the time of the investment no lower than investments defined under clause (i) by S&P; or

(iv) any certificate of deposit, including certificates of deposit issued by the Trustee or by a Paying Agent, secured by obligations specified in clause (i) above of a market value equal at all times to the amount of the deposit, which will be rated at the time of the investment no lower than investments defined under clause (i) by S&P.

"**Defeased Bonds**" means Bonds that remain in the hands of their Owners but are no longer deemed Outstanding because they have been defeased in accordance with the provisions of the Indenture.

"**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 the laws 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 only to the Pledged Accounts:

(i) Defeasance Collateral;

(ii) 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 Federal Housing Administration;

(iii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association, or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated "A-1" by S&P;

(iv) certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a state, a public authority or a political subdivision thereof, rated by S&P in one of its three highest rating categories;

(v) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than 270 days after the date of issuance thereof) that is rated "A-l" by S&P;

(vi) repurchase obligations with respect to any security described in clauses (i), (ii), or (iii) above entered into with a primary dealer, depository institution, or trust company (acting as principal) rated "A-1" by S&P (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated in one of the two highest long-term rating categories by S&P, or collateralized by securities described in clauses (i), (ii), or (iii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "BBB" or higher by S&P; 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 thirty 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 equal to at least 102% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered, suspended or withdrawn;

(vii) 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; 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;

(viii) units of taxable or tax-exempt money market funds which funds are regulated investment companies and are rated by S&P 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 Indenture, and (z) services performed for such funds and pursuant to the Indenture may converge at any time (the Corporation 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 Indenture);

(ix) any investment agreements or guaranteed investment contracts collateralized by securities described in clauses (i), (ii), or (iii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "BBB" or higher by S&P; 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 thirty 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 equal to at least 102% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered, suspended or withdrawn; and

(x) other obligations or securities that are non-callable and that do not adversely affect the then-existing rating of any Bonds;

provided, that no Eligible Investment may (a) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument, or (b) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity and provided further that funds managed or offered by the Trustee or funds for which the Trustee, its affiliates or subsidiaries, provide investment advisory or other management services may qualify as "Eligible Investments" if such funds otherwise satisfy the requirements of any of the clauses set forth above.

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.

"**Fiduciary**" means the Trustee, each Paying Agent and the Registrar.

"**Fiscal Year**" means the 12-month period ending each June 30, or such other 12-month period as the Board may determine from time to time to be the Corporation's fiscal year. In the event that the Board changes the Corporation's Fiscal Year, the Corporation will deliver an Officer's Certificate to the Trustee stating such change.

"**Fully Paid**" A Bond will be deemed "Fully Paid" only if:

(a) such Bond has been canceled by the Trustee or delivered to the Trustee for cancellation, including but not limited to under the circumstances described in the Indenture; or

(b) such Bond will have matured or been called for redemption and, on such maturity date or redemption date, money for the payment of the principal of, 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

(c) such Bond is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided in the Indenture; or

(d) 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).

"**Majority in Interest**" means the Owners of a majority of the Outstanding Bonds eligible to act on a matter, measured by face value at maturity or, if capital appreciation Bonds are issued, the accreted value of such capital appreciation Bonds.

"**Maturity Date**" means, with respect to any Bond, the final date on which all remaining principal of such Bond is due and payable.

"**Officer's Certificate**" means a certificate signed by an Authorized Officer of the Corporation.

"**Operating Cap**" means (a) (i) in the Fiscal Year ending June 30, 2017, $250,000, (ii) in the Fiscal Year ending June 30, 2018, $500,000 and (iii) in each following Fiscal Year, the Operating Cap for the prior Fiscal Year inflated 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 (b) in each Fiscal Year, Tax Obligations specified in an Officer's Certificate.

"**Operating Expenses**" means the reasonable operating expenses of the Corporation (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, insurance premiums, deductibles and retention payments, and costs of meetings or other required activities of the Corporation), legal fees and expenses of the Corporation, its members, directors, officers and employees, fees and expenses incurred for professional consultants and fiduciaries (including, but not limited to, computation of the amount of Tax Obligations and related computations), the fees, expenses, and disbursements of the Trustee, including the fees and expenses of counsel to the Trustee, costs incurred in order to preserve the tax-exempt status of any Tax-Exempt Bonds, the costs related to the Corporation's or the Trustee's enforcement rights with respect to the Indenture, the Agreement or the Bonds, and all Operating Expenses so identified in the Indenture. The term "Operating Expenses" does not include the Costs of Issuance to the extent paid with Bond proceeds.

"**Opinion of Counsel**" means a written opinion of Counsel.

"**Outstanding**" when used as of any particular time with respect to any Bonds, means all Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, delivered to the Trustee for credit against a principal payment or for cancellation, or purchased by the Corporation or the Trustee; (ii) Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds the payment of which will have been provided for pursuant to the Indenture or which are Fully Paid pursuant to the Indenture; and (v) for purposes of any consent or other action to be taken by the Owners of a Majority in Interest or specified percentage of Bonds under the Indenture, Bonds held by or for the account of the Corporation, or any Person controlling, controlled by, or under common control with the Corporation. For the purposes of this

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

"**Paying Agent**" means each Paying Agent designated from time to time pursuant to the Indenture.

"**Person**" means any individual, corporation, estate, partnership, joint venture, association, joint stock company, limited liability company, trust, unincorporated organization, government or any agency or political subdivision thereof, or any other entity of any type.

"**Pledged Tobacco Settlement Revenues**" **or** "**Pledged TSRs**" means, as of any date, the right, title and interest of the Corporation in and to 37.40% of the Tobacco Assets as of such date.

"**Pro Rata**" means, for an allocation of available amounts to any payment of interest or principal to be made under the Indenture, the application of a fraction to such available amounts (a) the numerator of which is equal to the amount due to the respective Owners to whom such payment is owing, and (b) the denominator of which is equal to the total amount due to all Owners to whom such payment is owing; provided, that only with respect to any payment of principal to be made Pro Rata under the Indenture, such payment will be made Pro Rata to the extent possible, and then any remaining balance of such payment of principal will be allocated by lot, in each case in applicable authorized denominations.

"**Projected Turbo Redemption**" means, for a series of Bonds, each respective Turbo Redemption projected to be made pursuant to the Indenture, as such projections are set forth on the Projected Turbo Schedule.

"**Projected Turbo Schedule**" means, for a series of Bonds that includes Turbo Bonds, the schedule of projected Outstanding balances of such Turbo Term Bonds set forth in the related Series Supplement or in an exhibit thereto.

"**Rating Agency**" means S&P, or if S&P no longer has a rating in effect for any of the Bonds, each nationally recognized securities rating service (if any) that does have a rating in effect for the Bonds at the request of the Corporation.

"**Rating Confirmation**" means written evidence that no rating that has been requested by the Corporation and is then in effect with respect to the Bonds from the Rating Agency will be withdrawn, reduced, or suspended solely as a result of an action to be taken under the Indenture, which determination must be made without giving effect to the rating conferred by or attributable to any credit enhancement then in effect with respect to such Bond.

"**Rebate Account**" means the Account, if any, established and maintained by the Trustee pursuant to the Indenture.

"**Senior Debt Service Account**" means the Account of such name held by the Trustee pursuant to the Indenture.

"**Senior Liquidity Reserve Requirement**" means, for as long as any Senior Bonds are Oustanding, an amount equal to $45,939,652.78[*], and otherwise $0.

"**Series 2017 Supplement**" means the Series Supplement authorizing the Series 2017 Bonds.

"**Series Supplement**" means the Series 2017 Supplement and any other Supplemental Indenture providing for the issuance of a series of Additional Bonds (including Refunding Bonds) or Junior Bonds in accordance with the Indenture.

[*] Preliminary, subject to change.

"**Sinking Fund Installment**" means each respective mandatory principal payment to be made on Term Bonds scheduled to be made from Collections pursuant to the Indenture, as such schedule is set forth in a Series Supplement.

"**Subordinate Debt Service Account**" means the Account of such name held by the Trustee pursuant to the Indenture.

"**Subordinate Liquidity Reserve Requirement**" means, for as long as any Subordinate Bonds are Oustanding, an amount equal to $20,546,666.67*, and otherwise $0.

"**Supplemental Indenture**" means a Series Supplement or other supplement to the Indenture or amendment thereof executed and delivered in accordance with the terms of the Indenture. Any provision that may be included in a Series Supplement or a Supplemental Indenture is also eligible for inclusion in the other, subject to the provisions of the Indenture.

"**Tax Certificate**" means the Tax Certificates executed by the Corporation and certain other parties at the time of issuance of the Series 2017 Bonds and each subsequent series of Tax-Exempt Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"**Tax Obligations**" means the Rebate Requirement (as such term is defined in the Tax Certificate) 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 Bond Maturity**" means the principal payment required to be made upon final maturity of any Term Bond, as set forth in a Series Supplement.

"**Trustee's Certificate**" means a certificate signed by an Authorized Officer of the Trustee.

"**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.

"**Unpledged TSRs**" means Tobacco Assets which are not Pledged TSRs.

"**Unpledged TSRs Subaccount**" means the subaccount in the Collections Account held by the Trustee pursuant to the Indenture.

"**Written Notice**" "**written notice**" or "**notice in writing**" means notice in writing which may be delivered by hand or first class mail, overnight delivery, electronically or by facsimile transmission.

THE INDENTURE

The following summary describes certain terms of the Indenture pursuant to which the Bonds will be issued. This summary does not purport to be complete and is subject and qualified in its entirety by reference to the provisions of the Indenture and the Bonds. Copies of the Indenture may be obtained upon written request to the Trustee. See "SECURITY FOR THE BONDS" and "THE SERIES 2017 BONDS" herein, for further descriptions of certain terms and provisions of the Bonds.

* Preliminary, subject to change.

No Liability on Bonds

Neither the members, directors or officers of the Corporation, the Board, the members of the Board, nor any person executing Bonds or other obligations of the Corporation will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance thereof.

The Bonds and other obligations of the Corporation will not be a debt of either the State or the City, and neither the State nor the City will be liable thereon, nor will they be payable out of any funds other than those of the Corporation; and the Bonds will contain on the face thereof a statement to such effect.

Security Interest and Pledge

In order to secure payment of the Bonds and the Residual Certificate, the Corporation pledges to the Trustee, and grants to the Trustee a first priority perfected security interest in, all of the Corporation's right, title, and interest, whether now owned or hereafter acquired, in, to, and under: (i) the Pledged Tobacco Settlement Revenues; (ii) the Pledged Accounts, all money, instruments, general intangibles, investment property, or other property credited to or on deposit in the Pledged Accounts, and all investment earnings on amounts on deposit in or credited to the Pledged Accounts; (iii) the enforcement of the covenants of the City contained in Article IV of the Agreement; (iv) all present and future claims, demands, causes, and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, general intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (v) all proceeds of the foregoing. The property described in the preceding sentence is referred to in the Indenture as the "Collateral." "Collateral" does not include Unpledged TSRs. Except as specifically provided in the Indenture, this assignment and pledge does not include: (i) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries, (ii) Section 5.02 of the Agreement or (iii) any right or power reserved to the Corporation pursuant to the Act, the Local Law or other law; nor does this paragraph preclude the Corporation's enforcement of its rights under and pursuant to the Agreement for the benefit of the Owners as provided in the Indenture. The Corporation will implement, protect and defend this assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. The foregoing collateral is pledged and a security interest is therein granted to secure the payment of Bonds and the Residual Certificate, all with the respective priorities specified in the Indenture. The Corporation covenants and agrees that it will implement, protect, and defend the security interest and pledge made in the Indenture by all appropriate action for the benefit of the Owners.

Defeasance

(a) *Total 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 terms of the Indenture, all obligations to Owners in whole (to be verified by a nationally recognized firm of independent verification agents), (ii) any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Trustee, (iii) all the rights under the Indenture of the Fiduciaries have been provided for, and (iv) the Trustee will have received an opinion of Counsel to the effect that such defeasance will not adversely affect the exclusion of interest on any Bond from gross income for federal income tax purposes, then upon Written Notice from the Corporation to the Trustee, such Owners will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture, the security interests created by the Indenture (except in such funds and investments) will terminate, and the Corporation, after providing for all Operating Expenses, and the Trustee will execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture and to make the Pledged TSRs and other Collateral payable to the order of the registered owner of the Residual Certificate. Upon such defeasance, the funds and investments required to pay or redeem the Bonds will be

irrevocably set aside for that purpose, subject, however, to the terms of the Indenture, and money held for defeasance will be invested only as provided in the Indenture and applied by the Trustee and other Paying Agents, if any, to the retirement of the Bonds. Any funds or property held by the Trustee and not required for payment or redemption of the Bonds will be distributed to the registered owner of the Residual Certificate.

(b) *Partial Defeasance*. Subject to the Corporation's tax covenants in the Indenture, the Corporation may create a defeasance escrow for the retirement and defeasance of any Bonds subject to and in accordance with the preceding paragraph (a), except that the obligations to all Owners need not be satisfied in whole and the lien and security interest of the Trustee under the Indenture for the benefit of the Bonds which have not been defeased will not terminate. Thereafter, the Owners of such Defeased Bonds will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds held in such defeasance escrow and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture.

Establishment of Accounts

Accounts Held by the Trustee. The Trustee will establish, hold and maintain the following segregated trust accounts in the Corporation's name:

(a) the Collections Account, and within the Collections Account the Unpledged TSRs Subaccount;

(b) the Operating Account;

(c) the Senior Debt Service Account;

(d) the Senior Liquidity Reserve Account;

(e) the Subordinate Extraordinary Payment Account;

(f) the Subordinate Debt Service Account;

(g) the Subordinate Liquidity Reserve Account;

(h) the Turbo Redemption Account;

(i) the Surplus Account;

(j) the Lump Sum Redemption Account;

(k) the Rebate Account; and

(l) the Costs of Issuance Account.

Investments

Generally. Pending its use under the Indenture, money in the Accounts held by the Trustee may be invested in Eligible Investments and will be so invested pursuant to an Officer's Certificate. Eligible Investments will mature or be redeemable at the option of the Corporation on or before the fifth Business Day immediately preceding each next succeeding Distribution Date, except in the case of the Liquidity Reserve Accounts to the extent that other Eligible Investments timely mature or are so redeemable in an amount sufficient to make payments in respect of interest, Serial Maturities, Sinking Fund Installments, Term Bond Maturities and Turbo Term Bond Maturities pursuant to the terms of the Indenture in respect to the Series of Bonds to which such Eligible Investments relate. Absent such Officer's Certificate, the Trustee will invest in Eligible Investments listed in clause (viii) of the definition thereof. Investments and any income realized therefrom will be held by the Trustee in the respective Accounts and will be sold or redeemed to the extent necessary to make payments or transfers from each Account. In

the absence of negligence or bad faith on its part, the Trustee will not be liable for any losses on investments made at the direction of the Corporation.

Liquidity Reserve Accounts. No later than May 15 and November 15 of each year commencing May 15, 2017, the Trustee will value the money and investments in each Liquidity Reserve Account according to the methods set forth in the Indenture. Any amounts in the Senior Liquidity Reserve Account in excess of, or anticipated (as shown in an Officer's Certificate) to be in excess of, the Senior Liquidity Reserve Requirement will be applied as provided in the Indenture and any amounts in the Subordinate Liquidity Reserve Account in excess of, or anticipated (as shown in an Officer's Certificate) to be in excess of, the Subordinate Liquidity Reserve Requirement will be applied as provided in the Indenture. If after receipt of any Pledged TSRs, the Trustee determines that a withdrawal from a Liquidity Reserve Account will be required on June 1 or December 1 of any year, the Trustee will as soon as practicable notify the provider under any forward purchase agreement relating to the applicable Liquidity Reserve Account of the estimated amount of the withdrawal and the projected date of the withdrawal. In no event will such notice be given later than ten (10) Business Days prior to the Business Day next preceding June 1 of such year.

Valuation. In computing the amount in any Account, the value of Eligible Investments will be determined as of no later than the fifth Business Day prior to each Distribution Date and as otherwise required under the Indenture. Except as otherwise specifically provided in the Indenture, all Eligible Investments will be valued at fair market value based on accepted industry standards by accepted industry providers, which will include, but are not limited to, pricing services provided by Financial Times Interactive Data Corporation.

Undivided Interests and Interfund Transfers. The Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible, but not including the Rebate Account) and may make interfund transfers in kind.

Notice of Uninvested Funds. The Trustee will promptly notify the Corporation of any funds that become uninvested under the Indenture and will request the Corporation to provide applicable instructions as to how to invest such funds.

Unclaimed Money

Except as may otherwise be required by applicable law, in case any money deposited with the Trustee or a Paying Agent for the payment of the principal of, or interest or premium, if any, on any Bond remains unclaimed for two years after such principal, interest, or premium has become due and payable, the Fiduciary may and upon receipt of a written request of the Corporation will pay over to the Corporation the amount so deposited and thereupon the Fiduciary will be released from all liability under the Indenture with respect to the payment of principal, interest, or premium and the Owner of such Bond will be entitled (subject to any applicable statute of limitations) to look only to the Corporation as an unsecured creditor for the payment thereof.

Unpledged TSRs

The Unpledged TSRs Subaccount will contain any funds previously deposited in accounts established under the Indenture and held by the Trustee that are not used for the defeasance of the Refunded Bonds or the funding of the Liquidity Reserve Accounts, any Collections after all Bonds are Fully Paid, and any Unpledged TSRs. The Unpledged TSRs Subaccount will be held by the Corporation and is not pledged to the Trustee for the benefit of the Owners. All amounts held in the Unpledged TSRs Subaccount will be transferred to the registered owner of the Residual Certificate.

Contract; Obligations to Owners; Representations of the Corporation

In consideration of the purchase and acceptance of any or all of the Bonds by those who will hold the same from time to time, the provisions of the Indenture will be a part of the contract of the Corporation with the Owners. The pledge and grant of a security interest made in the Indenture and the covenants set forth therein to be performed by the Corporation will be for the equal benefit, protection, and security of the Owners. All of the Bonds will be of

equal rank without preference, priority, or distinction of any thereof over any other except as expressly provided pursuant to the Indenture.

The Corporation covenants to pay when due all sums payable on the Bonds, but only from the Collateral and subject to the limitations set forth in the Indenture. The obligation of the Corporation to pay principal, interest, and redemption premium, if any, to the Owners will be absolute and unconditional, will be binding and enforceable in all circumstances whatsoever, and will not be subject to setoff, recoupment, or counterclaim.

The Corporation represents and warrants that (i) it is duly authorized under the Act and the Local Law to issue the Bonds, and to execute, deliver, and perform the terms of the Indenture; (ii) all action on its part required for or relating to the issuance of the Bonds and the execution and delivery of the Indenture has been duly taken; (iii) the Bonds, upon the issuance and authentication thereof, and the Indenture, upon the execution and delivery thereof, will be valid and enforceable obligations of the Corporation in accordance with their terms; (iv) it has not theretofore conveyed, assigned, pledged, granted a security interest in, or otherwise disposed of the Collateral, except with regard to the Refunded Bonds; and (v) the execution, delivery, and performance of the Indenture and the issuance of the Bonds are not in contravention of law or any agreement, instrument, indenture, or other undertaking to which it is a party or by which it is bound and no other approval, consent, or notice from any governmental agency is required on the part of the Corporation in connection with the issuance of the Bonds.

The Pledged TSRs and other Collateral are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all corporate action on the part of the Corporation to that end has been duly and validly taken. The Bonds and the provisions of the Indenture are and will be the valid and binding obligations of the Corporation in accordance with their terms.

For so long as any Bond is outstanding the Corporation will file, continue, and amend all such financing statements as may be necessary to establish and maintain the perfection and priority of the lien and security interest granted under the Indenture in the Collateral.

Operating Expenses

The Corporation will pay its Operating Expenses to the parties entitled thereto, to the extent that funds are available therefor.

Tax Covenants

The Corporation will at all times do and perform all acts and things permitted by law and the Indenture which are necessary in order to assure that interest paid on the Tax-Exempt Bonds will be excluded from gross income for federal income tax purposes and will take no action that would result in such interest not being excluded from gross income for federal income tax purposes. Without limiting the generality of the foregoing, the Corporation agrees that it will comply with the provisions of the Tax Certificate. This covenant will survive defeasance or redemption of the Tax-Exempt Bonds.

The property of the Corporation is irrevocably dedicated to charitable purposes. No part of the income or earnings of the Corporation will inure to the benefit or profit of, nor will any distribution of its property or assets be made to, any member, director or officer of the Corporation, or private person, corporate or individual, or to any other private interest, except that the Corporation may repay loans made to it and may repay contributions (other than dues) made to it to the extent that any such contribution may not be allowable as a deduction in computing taxable income under the Code.

The Corporation will not attempt to influence legislation by propaganda or otherwise, or participate in or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

Accounts and Reports

The Corporation will instruct the Trustee to keep books of account in which complete and accurate entries will be made of its transactions relating to all funds and accounts under the Indenture, which books will at all reasonable times be subject to the inspection of the Owners of an aggregate of not less than 25% in principal amount of Bonds then Outstanding or their representatives duly authorized in writing.

Affirmative Covenants

Maintenance of Existence. The Corporation will keep in full effect its corporate existence and all of its rights and powers.

Protection of Collateral. The Corporation will from time to time authorize, execute or authenticate, deliver and file all financing statements, continuation statements, amendments to financing statements, documents and instruments, and will take such other action, as is necessary or advisable to maintain or preserve the lien and security interest (and the perfection and priority thereof) of the Indenture; to perfect or protect the validity of any grant made or to be made by the Indenture; to preserve and defend title to the Collateral and the rights of the Trustee in the Collateral against the claims of all Persons and parties, including the challenge by any party to the validity or enforceability of the Indenture, the Consent Decree or the Agreement; to enforce the Agreement; to pay any and all taxes levied or assessed upon all or any part of the Collateral; or to carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Corporation will diligently pursue any and all actions to enforce its rights in the Collateral and under each instrument or agreement included therein, and will not take any action and will use its best efforts not to permit any action to be taken by others that would release any Person from any of such Person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination, or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Indenture, the Agreement or the Consent Decree.

Notice of Events of Default. The Corporation will give the Trustee and the Rating Agency prompt Written Notice of each Event of Default that is known to the Corporation.

Other. The Corporation will:

(1) conduct its own business in its own name and not in the name of any other Person;

(2) observe all formalities as a distinct entity;

(3) operate its business and activities such that it does not engage in any business or activity of any kind, or enter into any transaction or indenture, mortgage, instrument, agreement, contract, lease, or other undertaking, other than the transactions contemplated and authorized by the Indenture, and does not create, incur, guarantee, assume, or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (A) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (B) the incurrence of obligations under the Indenture, and (C) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Indenture;

(4) maintain its books and records separate from those of any other Person and maintain its assets readily identifiable as its own assets rather than assets of any other Person; and

(5) prepare financial statements separate from those of any other Person.

Negative Covenants

Sale of Assets. Except as expressly permitted by the Indenture, the Corporation will not sell, transfer, exchange, or otherwise dispose of any of its properties or assets, other than Unpledged TSRs or other properties or assets that are not subject to the lien of the Indenture.

Termination. The Corporation will not terminate its existence or engage in any action that would result in the termination of the Corporation.

Limitation of Liens. The Corporation will not (i) permit the validity or effectiveness of the Indenture to be impaired, or permit the security interest created by the Indenture to be amended, hypothecated, subordinated, terminated, or discharged, or permit any Person to be released from any covenants or obligations with respect to the Bonds under the Indenture except as may be expressly permitted by the Indenture, (ii) permit any lien, charge, excise, claim, security interest, mortgage, or other encumbrance (other than the security interest created by the Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the security interest created by the Indenture not to constitute a valid first priority security interest in the Collateral. Nothing in the Indenture will limit the Corporation's ability to issue Junior Bonds.

Payments Restricted. The Corporation will not, directly or indirectly, make distributions from the Collections Account except in accordance with the Indenture.

No Setoff. The Corporation will not claim any credit on, or make any deductions from the principal of or premium, if any, or interest due in respect of, the Bonds or assert any claim against any present or former Owner by reason of the payment of taxes levied or assessed upon any part of the Collateral.

Limitations on Consolidation, Merger, Sales of Assets, etc. Except as otherwise provided in the Indenture, the Corporation will not consolidate or merge with or into any other person, or convey or transfer all or substantially all of its properties or assets, or be succeeded by any other person, unless:

(i) the person surviving such consolidation or merger (if other than the Corporation), or such transferee, or such successor, as applicable, is organized and existing by virtue of or under the laws of the United States or any state and expressly assumes the due and punctual payment of the principal of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of the Corporation in the Indenture;

(ii) immediately after giving effect to such transaction, no Event of Default has occurred and is continuing under the Indenture;

(iii) the Corporation has received a Rating Confirmation;

(iv) the Corporation has received an opinion of Counsel to the effect that such transaction will not have material adverse tax consequences to the Corporation 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 security interest created by the Indenture has been taken; and

(vi) the Corporation has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

No Other Business. The Corporation will not engage in any business other than refunding the Refunded Bonds, issuing the Bonds and financing, purchasing, owning and managing the Collateral in the manner contemplated by the Indenture and activities incidental thereto.

Guarantees, Loan, Advances and Other Liabilities. Except as otherwise contemplated by the Indenture and the Agreement, the Corporation will not make any loan or advance of credit to, or guarantee (directly or indirectly or by an instrument having the effect or assuring another's payment or performance on any obligation or capability of so doing or otherwise), endorse or otherwise become contingently liable, directly or indirectly, in connection with the obligations, stock or dividends of, or own, purchase, repurchase or acquire (or agree contingently to do so) any stock, obligations, assets or securities of, or any other interest in, or make any capital contribution to, any other person.

Directors. The Corporation will not amend its charter or by-laws to eliminate the requirement of two directors who are independent of the City.

Prior Notice

The Trustee will give each Rating Agency 15 days prior Written Notice of any amendment to the Indenture or the defeasance or redemption of Bonds.

Continuing Disclosure Undertaking

The Corporation will comply with any continuing disclosure undertaking entered into with respect to any Bonds pursuant to Rule 15c2-12 of the Securities and Exchange Commission. Notwithstanding anything in the Indenture to the contrary, the sole remedy for any failure by the Corporation to comply with any such continuing disclosure undertaking will be specific performance pursuant to such continuing disclosure undertaking.

Trustee's Organization, Authorization, Capacity and Responsibility

The Trustee represents and warrants that it is duly organized and validly existing under the laws of the jurisdiction of its organization, having the authority to execute the trusts and perform its obligations under the Indenture, including the capacity to exercise the powers and duties of the Trustee under the Indenture, and that by proper corporate action it has duly authorized the execution and delivery of the Indenture.

The duties and responsibilities of the Trustee will be as provided by law and as set forth in the Indenture. Notwithstanding the foregoing, no provision of the Indenture will require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties under the Indenture, or in the exercise of any of its rights or powers, unless it receives indemnity satisfactory to it against any loss, liability, or expense; but the Trustee will perform its duties under the Indenture and, subject to the provisions under the heading "Rights and Duties of the Fiduciaries" of the Indenture, make the payments and distributions required by the Indenture without requiring that any indemnity be provided to it. Whether or not therein expressly so provided, every provision of the Indenture relating to the conduct or affecting the liability of or affording protection to the Trustee will be subject to the provisions of the Indenture.

As Trustee under the Indenture:

(1) the Trustee may conclusively rely and will be fully protected in acting or refraining from acting upon any Officer's Certificate, opinion of counsel (or both), resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness, or other paper or document believed by it to be genuine and to have been signed or presented by the proper person or persons. The Trustee need not investigate any fact or matter stated in the document, but the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit;

(2) before the Trustee acts or refrains from acting, it may require an Officer's Certificate and/or an opinion of counsel. The Trustee will not be liable for any action it takes or omits to take in good faith in reliance on such certificate or opinion. Whenever in the administration of the trusts of the Indenture the Trustee will deem it necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action under the Indenture, such matter (unless other evidence in respect thereof be specifically prescribed in the Indenture) may, in the absence of negligence or bad faith on the part of the Trustee, be deemed to be conclusively

proved and established by an Officer's Certificate delivered to the Trustee, and such certificate, in the absence of negligence or bad faith on the part of the Trustee, will be full warrant to the Trustee for any action taken, suffered or omitted to be taken by it under the provisions of the Indenture upon the faith thereof;

(3) any request, direction, order, or demand of the Corporation mentioned under the Indenture will be sufficiently evidenced by an Officer's Certificate (unless other evidence in respect thereof be specifically prescribed); and any Corporation resolution may be evidenced to the Trustee by a copy thereof certified by the secretary or an assistant secretary of the Corporation;

(4) prior to the occurrence of an Event of Default under the Indenture and after the curing or waiving of all Events of Default, the Trustee will not be bound to make any investigation into the facts or matters stated in any resolution, certificate, Officer's Certificate, opinion of Counsel, resolution, statement, instrument, opinion, report, notice, request, consent, order, approval, appraisal, bond, debenture, note, coupon, security, or other paper or document unless requested in writing so to do by a Majority in Interest of the Bonds affected and then Outstanding, and if the payment within a reasonable time to the Trustee of the costs, expenses, or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Trustee, not reasonably assured to the Trustee by the security afforded to it by the terms of the Indenture, the Trustee may require indemnity satisfactory to it against such expenses or liabilities as a condition to proceeding; and

(5) prior to an Event of Default or after a cure or a waiver of such an Event of Default, the Trustee undertakes to perform only such duties as are specifically set forth in the Indenture, and no implied covenants or obligations may be read into the Indenture against the Trustee and during all other times the Trustee will use the same degree of care and skill in the exercise of the rights and powers vested in it by the Indenture as prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

Rights and Duties of the Fiduciaries

All money and investments received by the Fiduciaries under the Indenture will be held in trust, in a segregated trust account in the trust department of such Fiduciary, not commingled with any other funds, and applied solely pursuant to the provisions of the Indenture.

The Fiduciaries will keep proper accounts of their transactions under the Indenture (separate from its other accounts), which will be open to inspection on reasonable notice by the Corporation and its representatives duly authorized in writing.

The Fiduciaries will not be required to monitor the financial condition of the Corporation and, unless otherwise expressly provided, will not have any responsibility with respect to reports, notices, certificates, or other documents filed with them under the Indenture, except to make them available for inspection by the Owners.

Each Fiduciary will be entitled to the advice of counsel (who may be counsel for any party) and will not be liable for any action taken in good faith in reliance on such advice. Each Fiduciary may rely conclusively on any notice, certificate, or other document furnished to it under the Indenture and reasonably believed by it to be genuine. A Fiduciary will not be liable for any error in judgment, action taken or omitted to be taken by it in good faith and reasonably believed by it to be within the discretion or power conferred upon it, or taken by it pursuant to any direction or instruction by which it is governed under the Indenture or omitted to be taken by it by reason of the lack of direction or instruction required for such action. When any payment or consent or other action by a Fiduciary is called for by the Indenture, the Fiduciary may defer such action pending receipt of such evidence, if any, as it may reasonably require in support thereof; except that the Trustee will make the payments and distributions required by the Indenture without requiring that any further evidence be provided to it. A permissive right or power to act will not be construed as a requirement to act.

No recourse will be had for any claim based on the Indenture or the Bonds against any director, officer, agent, or employee of any Fiduciary unless such claim is based upon the bad faith, negligence, willful misconduct, fraud or deceit of such person.

Nothing in the Indenture will obligate any Fiduciary to pay any debt or meet any financial obligations to any Person in relation to the Bonds except from money received for such purposes under the provisions of the Indenture or from the exercise of the Trustee's rights thereunder.

The Fiduciaries may be or become the owner of or trade in the Bonds and transact business generally with the Corporation and related entities with the same rights as if they were not the Fiduciaries.

The Fiduciaries will not be required to furnish any bond or surety.

Nothing under the Indenture will relieve any Fiduciary of responsibility for its negligence, bad faith or willful misconduct.

The Corporation will, as and only as an Operating Expense, indemnify and save each Fiduciary and each Trustee (as defined in the Amended and Restated Declaration and Agreement of Trust, dated as of January 1, 2006, as supplemented or amended, by and among the Corporation, Wilmington Trust Company, as Delaware Trustee, and the individual Trustees) harmless against any expenses and liabilities (including reasonable legal fees and expenses) that it may incur in the exercise of its duties under the Indenture and that are not due its negligence or bad faith, provided that indemnification with respect to a Trustee which is a natural person will be limited only to the extent such expense or liability is a result of the willful misconduct of such Trustee. This paragraph will survive the discharge of the Indenture or the earlier resignation or removal of such Fiduciary or Trustee.

Any fees, expenses, reimbursements or other charges which any Fiduciary may be entitled to receive from the Corporation under the Indenture, if not otherwise paid, will be a first lien upon (but only upon) any funds held under the Indenture by the Trustee for payment of Operating Expenses.

Resignation or Removal of the Trustee

The Trustee may resign on not less than 30 days Written Notice to the Corporation, the Owners, and the Rating Agency. The Trustee will promptly certify to the Corporation that it has given Written Notice to all Owners and such certificate will be conclusive evidence that such notice was given as required under the Indenture. The Trustee will provide notice to the Corporation within two (2) Business Days of any changes in its ratings by the Rating Agency and will be removed if rated below investment grade by the Rating Agency and each successor Trustee will have an investment grade rating from the Rating Agency. The Trustee may be removed by Written Notice from the Corporation (if not in default) or a Majority in Interest of the Outstanding Bonds to the Trustee and the Corporation. Such resignation or removal will not 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 related corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation, or otherwise, will thereby become vested with all the property, rights, powers, and duties thereof under the Indenture, without any further act or conveyance.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator, or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary will with due care terminate its activities under the Indenture and a successor may, or in the case of the Trustee will, be appointed by the Corporation. The Corporation will notify the Owners and the Rating Agency of the appointment of a successor Trustee in writing within 20 days from the appointment. The Corporation will promptly certify to the successor Trustee that it has given such notice to all Owners and such certificate will be conclusive evidence that such notice was given as required under the Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of Written Notice in accordance with the provisions relating to the resignation or removal of the Trustee under the Indenture or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Owner 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 this section will be a bank or trust company eligible under the laws of the State and will have a capital and surplus of not less than $50,000,000. Any such successor Trustee will notify the Corporation of its acceptance of the appointment and, upon giving such notice, will become Trustee, vested with all the property, rights, powers, and duties of the Trustee under the Indenture, without any further act or conveyance. Such successor Trustee will execute, deliver, record, and file such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Trustee will from time to time execute, deliver, record, and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Indenture.

Reports by Trustee to Owners and Rating Agency

The Trustee will deliver to each Rating Agency, the Corporation, the owner of the Residual Certificate, and any Owner upon request, with respect to the Bonds, at least one Business Day prior to each Distribution Date therefor, a statement prepared by the Trustee with the assistance of the Corporation setting forth:

(a) the Outstanding Bonds on such Distribution Date;

(b) the amount of interest to be paid to Owners on such Distribution Date;

(c) any Serial Maturity, Turbo Term Bond Maturity or Sinking Fund Installment due on or scheduled for such Distribution Date and the Turbo Redemptions to be made as of that Distribution Date;

(d) the amount on deposit in each Account as of that Distribution Date; and

(e) whether the amount on deposit in each Liquidity Reserve Account is sufficient to satisfy the applicable Liquidity Reserve Requirement as of such Distribution Date and, if not, the amount of the shortfall.

Nonpetition Covenant

Notwithstanding any prior termination of the Indenture, no Fiduciary or Bondowner will, prior to the date which is one year and one day after the termination of the Indenture, acquiesce, petition, or otherwise invoke or cause the Corporation or the SPE to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against the Corporation under any federal or state bankruptcy, insolvency, or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator, or other similar official of the Corporation or the SPE or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Corporation or the SPE.

Action by Owners

Any request, authorization, direction, notice, consent, waiver, or other action provided by the Indenture to be given or taken by Owners may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Owners or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, will be sufficient for any purpose of the Indenture (except as otherwise expressly provided in the Indenture) if made in the following manner, but the Corporation 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 Owner or its attorney of such instrument may be proved by the certificate or signature guarantee by a guarantor institution participating in a guarantee program acceptable to the Trustee, or of any notary public or other officer authorized to take acknowledgements of deeds to be recorded in the jurisdiction in which such notary public or other officer purports to act, that the person signing such request or other instrument acknowledged to such notary public or other officer the execution thereof, or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Owner 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 will be irrevocable and bind all future record and beneficial owners thereof.

Registered Owners

The enumeration of certain provisions of the Indenture applicable to DTC as Owner of immobilized Bonds will not be construed in limitation of the rights of the Corporation and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions of the Indenture, any payment to the registered owner of a Bond will satisfy the Corporation's obligations thereon to the extent of such payment.

Events of Default

"Event of Default" in the Indenture means any one of the events set forth below:

(a) a Senior Payment Default;

(b) a Subordinate Payment Default;

(c) failure of the Corporation to observe or perform any other covenant, condition, agreement, or provision contained in the Bonds or in the Indenture (other than the covenant described under "Continuing Disclosure Undertaking" above), which breach is not remedied within 60 days after Written Notice, specifying such default and requiring the same to be remedied, has been given to the Corporation by the Trustee or by the Owners of at least 25% in principal amount of the Bonds then Outstanding; provided, however, if the default be such that it cannot be corrected within the said 60-day period, it will not constitute an Event of Default if corrective action is instituted by the Corporation within said 60-day period and diligently pursued until the default is corrected; and

(d) failure of the City to observe or perform its covenant included in the Indenture for the benefit of the Owners, which failure is not remedied within 60 days after Written Notice thereof is given by the Trustee to the City and the Corporation or by the Corporation to the Trustee and the City, if a majority of the Owners of the then Outstanding Bonds declares an Event of Default; provided, however, if the default be such that it cannot be corrected within the said 60-day period, it will not constitute an Event of Default if corrective action is instituted by the Corporation or the City, as applicable, within said 60-day period and diligently pursued until the default is corrected.

Notwithstanding the foregoing, a Subordinate Payment Default (i) will not cause any Senior Bonds to be deemed to be in default if the payment of all interest and principal then due on such Senior Bonds has been timely paid, and (ii) until no Senior Bonds remain Outstanding, will not give rise to any of the remedies described above being available to cure any such nonpayment of Subordinate Bonds.

Remedies

Remedies of the Trustee. If an Event of Default occurs:

(1) The Trustee may, and upon written request of the Owners of at least 25% in principal amount of the Bonds Outstanding will, in its own name by action or proceeding in accordance with law:

(a) enforce all rights of the Owners and require the Corporation or the City to carry out their respective agreements under the Bonds, the Indenture or the Agreement;

(b) sue upon such Bonds;

(c) require the Corporation to account as if it were the trustee of an express trust for such Owners; and

(d) enjoin any acts or things which may be unlawful or in violation of the rights of such Owners.

(2) The Trustee will, in addition to the other provisions of this section, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Owners in the enforcement and protection of their rights.

(3) Upon an Event of Default under (a) or (b) under the definition of "Events of Default" above, or a failure to make any other payment required under the Indenture within 7 days after the same becomes due and payable, the Trustee will give Written Notice thereof to the Corporation. The Trustee will give notice under subsection (c) or (d) under the definition of "Events of Default" above when instructed to do so by the written direction of another Fiduciary or the Owners of at least 25% in principal amount of the Outstanding Bonds. Upon the occurrence of an Event of Default, the Trustee will proceed under the provisions of the Indenture for the benefit of the Owners in accordance with the written direction of a Majority in Interest of the Outstanding Bonds. The Trustee will not be required to take any remedial action (other than the giving of notice) unless 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 will promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Owners, and will act for the protection of the Owners with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Individual Remedies. No one or more Owners will by its or their action affect, disturb, or prejudice the pledge created by the Indenture, or enforce any right under the Indenture, except in the manner therein provided, and all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had, and maintained in the manner provided therein and for the equal benefit of all Owners of the same class, but nothing in the Indenture will affect or impair the right of any Owner to enforce payment of the principal of, premium, if any, or interest thereon at and after the same comes due pursuant to the Indenture, or the obligation of the Corporation to pay such principal, premium, if any, and interest on each of the Bonds to the respective Owners thereof at the time, place, from the source, and in the manner expressed in the Indenture and in the Bonds.

Venue. The venue of every action, suit, or special proceeding against the Corporation will be laid in federal or state courts located in The City and County of New York, New York unless waived by the Corporation.

Waiver. If the Trustee determines that any 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 Corporation, and will do so upon written instruction of the Owners of at least 25% in principal amount of the Outstanding Bonds.

Remedies Cumulative

The rights and remedies under the Indenture are cumulative and do not exclude any other rights and remedies allowed by law, provided there is no duplication of recovery. The failure to insist upon a strict performance of any of the obligations of the Corporation or to exercise any remedy for any violation thereof will not be taken as a waiver for the future of the right to insist upon strict performance by the Corporation or of the right to exercise any remedy for the violation.

Delay or Omission Not a Waiver

No delay or omission of the Trustee or of any Owner to exercise any right or remedy accruing upon any Event of Default will impair any such right or remedy or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given under the Indenture or by law to the Trustee or to the Owners

may be exercised from time to time, and as often as may be deemed expedient, by the Trustee or by the Owners, as the case may be.

No Sale of Rights Under the Agreement

Neither the Trustee nor the Owners shall have the right to sell or foreclose on the Tobacco Assets or the rights of the Corporation under the Agreement.

Supplements and Amendments to the Indenture

The Indenture may be supplemented or amended in writing by the Corporation and the Trustee, to (i) provide for earlier or greater deposits into the Debt Service Account, (ii) subject any property to the security interest created by the Indenture, (iii) add to the covenants and agreements of the Corporation or surrender or limit any right or power of the Corporation, (iv) identify particular Bonds for purposes not inconsistent with the Indenture, including credit or liquidity support, remarketing, qualification for sale under the securities laws of any state or other jurisdiction of the United States and defeasance, (v) cure any ambiguity or defect, (vi) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, (vii) make any other changes to the Indenture if such change is accompanied by a Rating Confirmation, (viii) provide for the issuance of the Series 2017 Bonds, Additional Bonds (including Refunding Bonds) and Junior Bonds in compliance with the Indenture; or (ix) adopt amendments that do not take effect unless and until such amendment is consented to by such Owners in accordance with the further provisions of the Indenture.

Except as provided in the foregoing paragraph, the Indenture may be amended:

(i) only with Written Notice to the Rating Agency and the written consent of (a) if the Senior Bonds are affected thereby, a Majority in Interest of the Senior Bonds to be Outstanding at the effective date thereof and affected thereby and (b) if the Subordinate Bonds are affected thereby, a Majority in Interest of the Subordinate Bonds to be Outstanding at the effective date thereof; but

(ii) only with the unanimous written consent of the affected Owners for any of the following purposes: (a) to extend the maturity of any Bond, (b) to reduce the principal amount, applicable premium, or interest rate of any Bond, (c) to make any Bond redeemable other than in accordance with its terms, (d) to create a preference or priority of any Bond over any other Bond of the same class or (e) to reduce the percentage of the Bonds required to be represented by the Owners giving their consent to any amendment.

Any amendment of the Indenture will be accompanied by an opinion of Counsel to the effect that the amendment is permitted by the Indenture and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

When the Corporation determines that the requisite number of consents have been obtained for an amendment to the Indenture, it will file a certificate to that effect in its records and give notice to the Trustee and the Owners. The Trustee will promptly certify to the Corporation that it has given such notice to all Owners and such certificate will be conclusive evidence that such notice was given in the manner required by the Indenture. It will not be necessary for the consent of Owners pursuant to the Indenture to approve the particular form of any proposed amendment, but it will be sufficient if such consent will approve the substance thereof.

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