NEW ISSUE | BOOK-ENTRY ONLY

In the opinion of Orrick, Herrington & Sutcliffe LLP, Transaction Counsel ("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, interest on the Series 2006-1 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is excluded from New York adjusted gross income for purposes of personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York), to the extent that such interest is excluded from gross income for federal income tax purposes. Transaction Counsel is of the further opinion that interest on the Series 2006-1 Bonds is 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 tax consequence related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006-1 Bonds. See "Tax Exemption and Other Tax Matters" herein for further information.

$1,353,510,000
TSASC, INC.
Tobacco Settlement Asset-Backed Bonds, Series 2006-1

TSASC, Inc. ("**TSASC**") is a local development corporation organized under the Not-For-Profit Corporation Law of the State of New York. 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 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 (such payments and rights, as more fully described herein, the "**Tobacco Settlement Revenues**" or "**TSRs**") to be made by the participating manufacturers under the MSA.

The Tobacco Settlement Asset-Backed Bonds, Series 2006-1 (the "**Series 2006-1 Bonds**") are to be issued pursuant to an Indenture (as amended and restated) between TSASC and The Bank of New York, as Indenture Trustee, and a Series Supplement thereto (as such terms are defined herein) for the purpose of refunding all of TSASC's outstanding indebtedness. The Indenture also permits the issuance of Additional Parity Bonds (as defined herein) subject to the satisfaction of certain conditions described herein and therein. The Series 2006-1 Bonds, together with any Additional Parity Bonds issued under the Indenture, are referred to herein as the "**Bonds**." Subordinate bonds may also be issued for any purpose by TSASC if there is no payment permitted thereon until all then outstanding Bonds are fully paid.

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 a specific percentage of the Tobacco Assets, initially 37.40% which is subject to reduction after June 1, 2024 upon the satisfaction of certain conditions as more fully set forth under "SECURITY FOR THE BONDS" herein. TSASC has no financial assets available for payment of the Bonds other than the Pledged TSRs and the other collateral. 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 (the "**Unpledged TSRs**").

The amount of Pledged TSRs received is dependent on many factors, including future cigarette consumption, the financial capability of the PMs, litigation affecting the MSA and related state legislation, enforcement of state legislation related to the MSA, and the tobacco industry. See "RISK FACTORS" herein.

Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Freedom Holdings* and *Grand River*, both discussed in "RISK FACTORS" herein), that are pending in the United States District Court for the Southern District of New York. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of Pledged TSRs available to TSASC to pay debt service on the Bonds and make Turbo Redemptions (herein defined), and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

Interest on the Series 2006-1 Bonds will be payable semi-annually on June 1 and December 1 of each year, commencing June 1, 2006.

Bear, Stearns & Co. Inc. | **Citigroup** | **JPMorgan**

First Albany Capital Inc. | **Goldman, Sachs & Co.** | **Lehman Brothers**
Merrill Lynch & Co. | **Morgan Stanley** | **RBC Capital Markets** | **UBS Investment Bank**

Banc of America Securities LLC | **M.R. Beal & Company** | **Fidelity Capital Markets**
LaSalle Financial Services, Inc. | **Loop Capital Markets LLC** | **Ramirez & Co., Inc.**
Raymond, James & Associates, Inc. | **Roosevelt & Cross Incorporated** | **Siebert Brandford Shank & Co.**
Southwest Securities | **Wachovia Bank, National Association**

February 3, 2006

(Continued from front cover)

The Series 2006-1 Bonds consist of Turbo Term Bonds maturing on June 1 in the years as set forth on the opposite page (each such date, a "**Maturity Date**"). The Series 2006-1 Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments therefor and, in addition, are subject to mandatory redemption to the extent of available Collections as defined herein ("**Turbo Redemptions**"). Turbo Redemptions, if any, will be credited against both Sinking Fund Installments therefor and Turbo Term Bond Maturities in chronological order. As a consequence, payment of principal of the Series 2006-1 Bonds may be substantially earlier than the scheduled Sinking Fund Installments and Maturity Dates therefor. The Series 2006-1 Bonds are also subject to optional and mandatory redemption and extraordinary prepayment, all as described herein.

Failure to pay interest when due or the principal of a Series 2006-1 Bond on its Maturity Date will constitute an Event of Default under the Indenture. However, failure to pay Sinking Fund Installments or Turbo Redemptions on Series 2006-1 Bonds will not constitute an Event of Default under the Indenture. **The ratings for the Series 2006-1 Bonds address only (i) the payment of interest thereon when due and (ii) the payment of principal thereof by their respective Maturity Dates. The ratings do not address the payment of Sinking Fund Installments on Series 2006-1 Bonds or Turbo Redemptions. See "RATINGS" herein.**

See the Opposite Page for Dated Date, Maturity Schedule, Interest Rates and Prices or Yields.

The Series 2006-1 Bonds are limited obligations of TSASC and payable solely from the Pledged TSRs and the other collateral pledged under the Indenture. The Series 2006-1 Bonds are not 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, or shall be deemed to be, pledged to the payment of any of the Series 2006-1 Bonds. TSASC has no taxing power.

See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with an investment in the Series 2006-1 Bonds.

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

The Series 2006-1 Bonds are offered when, as and if issued 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 Sidley Austin LLP, New York, New York, as Underwriters' Counsel. It is expected that the Series 2006-1 Bonds will be available for delivery in book-entry only form through The Depository Trust Company in New York, New York on or about February 8, 2006.

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

$1,353,510,000
Series 2006-1 Bonds
Dated: Date of Delivery

$284,070,000 4¾% Series 2006-1 Turbo Term Bonds due June 1, 2022; Yield: 4.83%
Projected Final Turbo Redemption Date: June 1, 2015*
Projected Average Life: 4.8 years*
CUSIP No. 898526 CX4‡

$137,765,000 5.00% Series 2006-1 Turbo Term Bonds due June 1, 2026; Yield: 5.125%
Projected Final Turbo Redemption Date: June 1, 2017*
Projected Average Life: 10.4 years*
CUSIP No. 898526 CY2‡

$372,650,000 5.00% Series 2006-1 Turbo Term Bonds due June 1, 2034; Yield: 5.25%
Projected Final Turbo Redemption Date: June 1, 2022*
Projected Average Life: 14.4 years*
CUSIP No. 898526 CZ9‡

$559,025,000 5⅛% Series 2006-1 Turbo Term Bonds due June 1, 2042; Yield: 5.35%
Projected Final Turbo Redemption Date: June 1, 2033*
Projected Average Life: 20.4 years*
CUSIP No. 898526 DA3‡

THE CUSIP NUMBERS LISTED ABOVE ARE BEING PROVIDED SOLELY FOR THE CONVENIENCE OF BONDHOLDERS ONLY AT THE TIME OF ISSUANCE OF THE SERIES 2006-1 BONDS. TSASC, THE CITY AND THE UNDERWRITERS DO NOT MAKE ANY REPRESENTATION WITH RESPECT TO SUCH NUMBERS OR UNDERTAKE ANY RESPONSIBILITY FOR THEIR ACCURACY NOW OR AT ANY TIME IN THE FUTURE. THE CUSIP NUMBER FOR A SPECIFIC MATURITY IS SUBJECT TO BEING CHANGED AFTER THE ISSUANCE OF THE SERIES 2006-1 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 2006-1 BONDS.

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* Assumes all Turbo Redemptions are made based on the receipt of Surplus Collections (as defined herein) in accordance with the Global Insight Base Case Forecast and other structuring assumptions. No assurance can be given that these assumptions will be realized. Projections of Turbo Redemptions for the Series 2006-1 Bonds have not been rated by any Rating Agency. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

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 CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2006-1 BONDS WILL DEVELOP OR, IF ONE DEVELOPS, THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2006-1 BONDS.

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

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

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the factors that may materially affect the amount of Pledged TSRs (see “RISK FACTORS,” “LEGAL CONSIDERATIONS,” “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT” and “THE NEW YORK CONSENT DECREE”), 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 advisor, the City, Global Insight or the Underwriters that such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

If and when included in this Offering Circular, the words “expects,” “forecasts,” “projects,” “intends,” “anticipates,” “estimates,” “assumes” and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. Such risks and uncertainties include, among others, general economic and business conditions, changes in political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation and various other events, conditions and circumstances, many of which are beyond the control of TSASC. These forward-looking statements speak only as of the date of this Offering Circular. TSASC disclaims any obligation or undertaking to release publicly 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 SERIES 2006-1 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AGENCY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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

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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 2006-1 Bonds to potential investors is made only by means of the entire Offering Circular. Capitalized terms used in this Summary Statement and not otherwise defined shall have the meanings given such terms in the Indenture and the TSR Purchase Agreement. See Appendix F "—DEFINITIONS AND SUMMARY OF THE INDENTURE—Definitions" attached hereto. For definitions of certain terms used herein, see also Appendix H "—INDEX OF DEFINED TERMS" attached hereto.

Overview .... TSASC is issuing $1,353,510,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2006-1 (the "**Series 2006-1 Bonds**") for the purpose of refunding all of its outstanding indebtedness. The Series 2006-1 Bonds are being issued pursuant to the Indenture hereinafter referred to. In addition to the Series 2006-1 Bonds, the Indenture permits the issuance of Additional Parity Bonds (as defined herein) subject to the satisfaction of certain conditions described herein and therein. The Series 2006-1 Bonds, together with any Additional Parity Bonds issued under the Indenture, are referred to herein as the "**Bonds**." Subordinate bonds may also be issued for any purpose by TSASC if there is no payment permitted thereon until all then outstanding Bonds are fully paid. See "THE SERIES 2006-1 BONDS—Additional Bonds" herein.

TSASC has, pursuant to the TSR Purchase Agreement hereinafter referred to, purchased all of the right, title and interest of The City of New York (the "**City**") under the Master Settlement Agreement (the "**MSA**") and the Consent Decree and Final Judgment related thereto (the "**Tobacco Assets**"), including the City's right to receive its portion of the Annual Payments (as defined and described in the MSA) payable under the MSA (the "**Tobacco Settlement Revenues**" or "**TSRs**"). The Series 2006-1 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 a specific percentage of the Tobacco Assets, initially 37.40% which is subject to reduction after June 1, 2024 upon the satisfaction of certain conditions as more fully set forth under "SECURITY FOR THE BONDS" herein.

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 (the "**Unpledged TSRs**"). The Indenture Trustee shall have no right to any Unpledged TSRs under any circumstances, 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.

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.

Securities Offered........................ The Series 2006-1 Bonds will be issued pursuant to an Amended and Restated Indenture, dated as of January 1, 2006 (the "**Indenture**"), between TSASC and The Bank of New York, as trustee (the "**Indenture Trustee**"), and a series supplement thereto (the "**Series 2006-1 Supplement**"), to be entered into between TSASC and the Indenture Trustee in connection with the issuance of the Series 2006-1 Bonds.

It is expected that the Series 2006-1 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about February 8, 2006 (the "**Closing Date**"). Individual purchases of beneficial ownership interests may be made in the principal amount of $5,000 or any integral multiple thereof. Beneficial owners of the Series 2006-1 Bonds will not receive physical delivery of bond certificates.

Collateral .... 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 Pledged Accounts (as defined herein), 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 Operating Account, the Operating Contingency Account, or the Rebate Account) and all investment earnings on amounts on deposit in or credited to the Pledged Accounts; (c) any payment received by TSASC pursuant to a Swap Contract (as defined herein); and (d) 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 TSRs pledged under the Indenture (the "**Pledged TSRs**") represent, as of any date, the right, title and interest of TSASC in and to the Applicable Percentage of the Tobacco Assets as of such date. The "**Applicable Percentage**" means 37.40%; provided, however, that on June 1, 2024 and on each June 1 thereafter if Cumulative Actual Turbo Redemptions equal or exceed the Cumulative Projected Turbo Redemptions, the Applicable Percentage will mean the percentage shown on the following table opposite such June 1 and shall become effective on the next day.

Applicable Percentage of Pledged TSRs

	Cumulative Projected Turbo Redemptions	Applicable Percentage	Effective Date of Applicable Percentage
June 1, 2024	$996,165,000	30.10%	June 2, 2024
June 1, 2025	1,077,725,000	18.68	June 2, 2025
June 1, 2026	1,126,925,000	18.68	June 2, 2026
June 1, 2027	1,179,450,000	18.68	June 2, 2027
June 1, 2028	1,235,485,000	18.68	June 2, 2028
June 1, 2029	1,295,230,000	4.25	June 2, 2029
June 1, 2030	1,308,465,000	4.25	June 2, 2030
June 1, 2031	1,322,530,000	4.25	June 2, 2031
June 1, 2032	1,337,455,000	4.25	June 2, 2032 and thereafter

Upon the issuance of Additional Parity Bonds the definition of Pledged TSRs will be amended to take into account the issuance of such Bonds.

"**Cumulative Actual Turbo Redemptions**" means, as of June 1, 2024, and each June 1 thereafter, the principal amount of all actual redemptions from the date of issuance of the Series 2006-1 Bonds through and including such June 1.

"**Cumulative Projected Turbo Redemptions**" means, as of June 1, 2024, and each June 1 thereafter, the amount shown on the preceding table under "Cumulative Projected Turbo Redemptions" opposite such June 1.

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

"OPMs" means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, means, collectively, Philip Morris, Reynolds American and Lorillard. As reported by Loews Corporation, the OPMs accounted for approximately 85%[†] of the United States domestic cigarette market in 2004, based upon shipments.

The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past and present smoking-related claims and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States (including Annual Payments as defined herein), and imposed certain tobacco advertising and marketing restrictions on the OPMs, among other things. The MSA represents the resolution of a large potential financial liability of the OPMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. TSASC is not a party to the MSA.

The MSA provides for tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies that become parties to the MSA after the OPMs are referred to herein as "**Subsequent Participating Manufacturers**" or "**SPMs**" and the SPMs, together with the OPMs, are referred to herein as the "**Participating Manufacturers**" or "**PMs**." Tobacco companies that do not become parties to the MSA are referred to herein as "**Non-Participating Manufacturers**" or "**NPMs**." See "SUMMARY OF THE MSA" herein.

New York Consent Decree .... Under the MSA, the State is entitled to 12.7620310% of the Annual Payments made by PMs under the MSA. The Decree, which was entered into by the Supreme Court of the State of New York in December 1998, allocates this share of the Initial Payments and Annual Payments among the State (51.176%), the City (26.670%) and certain counties within the State (22.154%). The State is entitled to receive other payments in which the City (and therefore TSASC) does not have an interest under the Decree. The Decree became final on August 17, 1999 and is not subject to further appeal. See "SUMMARY OF THE MSA" and "NEW YORK CONSENT DECREE" herein.

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

Litigation Regarding MSA and Related Statutes .... Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Freedom Holdings* and *Grand River*, discussed in "RISK FACTORS" herein), that are pending in the United States District Court for the Southern District of New York. The plaintiffs in both cases seek, inter alia, a determination that state statutes enacted pursuant to the MSA conflict with and are preempted by the federal antitrust laws. The plaintiffs in the *Grand River* case also seek a determination that state statutes enacted pursuant to the MSA violate the Commerce Clause of the United States Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of Pledged TSRs available to TSASC to pay the principal of and interest on the Bonds and to make Turbo Redemptions (herein defined), and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

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

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

See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Annual Payments."

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment based on its respective market share of the United States cigarette market during the preceding calendar year, in

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

each case, subject to certain adjustments as described herein. Each SPM has Annual Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share. The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent, which is required, in turn, pursuant to the instructions of the MSA Escrow Agreement, to remit an allocable share of such payments to the parties entitled thereto.

Under the MSA, the Annual Payments due are subject to numerous adjustments, some of which may be material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments and to account for those states that settle or have settled their claims against the PMs independently of the MSA and increases related to inflation in an amount of not less than 3% per year.

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, TSASC has assigned and pledged only the Pledged TSRs to the Indenture Trustee. 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 do not pass through the State or the City and are not 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 .... The three OPMs – Philip Morris, Reynolds American and Lorillard – are the largest manufacturers of cigarettes in the United States (based on 2004 market share). According to Loews Corporation, the parent of Lorillard, the OPMs accounted for approximately 85% of the

United States domestic cigarette market in 2004 based on shipments.* The market for cigarettes is highly competitive and is characterized by brand recognition and loyalty. See "DOMESTIC TOBACCO INDUSTRY" herein. In structuring the Series 2006-1 Bonds, it was assumed that the relative market share for each class of cigarette manufacturers remains constant at 85.1% for the OPMs, 8.7% for the SPMs and 6.2% for the NPMs. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

Cigarette Consumption .... As described in the Global Insight Consumption Report described below, domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980's and 1990's, falling to an estimated 393 billion cigarettes in 2004. A number of factors affect consumption, including, but not limited to, pricing, industry advertising, expenditures, health warnings, restrictions on smoking in public places, nicotine dependence, youth consumption, general population trends and disposable income. See "GLOBAL INSIGHT CONSUMPTION REPORT."

Global Insight Consumption Report .... Global Insight (USA), Inc. ("**Global Insight**"), an international econometric and consulting firm, was retained on behalf of TSASC to forecast cigarette consumption in the United States from 2004 through 2042. Global Insight's report, entitled "A Forecast of U.S. Cigarette Consumption (2004-2042) for TSASC, INC." dated February 3, 2006 (the "**Global Insight Consumption Report**") is attached hereto as Appendix A and should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions contained therein. The Global Insight Consumption Report is subject to certain disclaimers and qualifications as described therein. See APPENDIX A.

Global Insight considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. Global Insight found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places and the trend over time in individual behavior and preferences. Using

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* Market share information for the OPMs based on domestic industry shipments may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Annual Payments. See "*Annual Payments*" in "SUMMARY OF THE MSA" herein. Additionally, aggregate market share information as reported by the Loews Corporation is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of the filings with the SEC. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" and "TOBACCO INDUSTRY" herein.

data from 1965 to 2003 and an analysis of the variables, Global Insight constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the United States. Using standard multivariate regression analysis to determine the relationship between such variables and CPC along with Global Insight's standard adult population growth statistics and adjustments for non-adult smoking, Global Insight projected adult cigarette consumption through 2042.

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

Interest .... Interest on the outstanding principal amount of the Series 2006-1 Bonds will be payable on each June 1 and December 1, commencing June 1, 2006. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Liquidity Reserve Account is available to pay interest on Bonds when due. Failure to pay the full amount of interest on the Bonds when due is an Event of Default. See "DEFINITIONS AND SUMMARY OF THE INDENTURE – Events of Default" in Appendix F.

Turbo Term Bond Maturities.... The Series 2006-1 Bonds are expected to be issued as Turbo Term Bonds. The Series 2006-1 Bonds will mature on June 1, in years 2022, 2026, 2034 and 2042. The Series 2006-1 Bonds are subject to scheduled Sinking Fund Installments and Turbo Redemptions as described below.

Sinking Fund Installments .... The "**Sinking Fund Installments**" of the Series 2006-1 Bonds represent the amount of principal that TSASC will pay as of the specified Distribution Date (as defined herein) to the extent of available Collections as set forth in the schedules under "THE SERIES 2006-1 BONDS – Sinking Fund Installments" herein. "**Collections**" consist of all funds collected with respect to Pledged TSRs, amounts paid to TSASC under any Swap Contract, and investment earnings on the Pledged Accounts. Failure by TSASC to pay the Sinking Fund Installments of the Series 2006-1 Bonds when due will not constitute an Event of Default under the Indenture.

Amounts in the Liquidity Reserve Account will not be available to pay Sinking Fund Installments.

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

Turbo Redemptions .... The Indenture requires that all Collections that are in excess of the amounts required for the funding of Operating Expenses, interest, Sinking Fund Installments, Turbo Term Bond Maturities, deficiencies in the Liquidity Reserve Account, if any, and the Operating Contingency Account (such excess, "**Surplus Collections**") be applied to the redemption of the Series 2006-1 Bonds on each Distribution Date as described herein (each such payment, a "**Turbo Redemption**"). Such Surplus 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 Surplus Collections, if any. Turbo Redemptions may also be made from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each Rating Agency that no rating then in effect with respect to the Series 2006-1 Bonds from such Rating Agency will be withdrawn, reduced or suspended. Amounts in the Liquidity Reserve Account are not available to make Turbo Redemptions. See "Projected Final Turbo Redemption Dates" listed on the inside front cover hereof and "THE SERIES 2006-1 BONDS – Turbo Redemptions" herein.

"**Projected Turbo Redemption**" means each respective Turbo Redemption projected to be made, as such projections are set forth in the table under "THE SERIES 2006-1 BONDS – Turbo Redemptions" herein.

Limitation on
Open Market Purchases .... Moneys in the Pledged Accounts will not be used to make open market purchases of the Series 2006-1 Bonds.

Optional Redemption................. The Series 2006-1 Bonds are subject to optional redemption (from any source other than Collections) 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 at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Series 2006-1 Bonds, and (2) in whole or in part on any date on or after June 1, 2016, 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.

Redemption of Defeased Bonds . In the event of a full or partial defeasance of the Series 2006-1 Bonds, the defeasance escrow will be structured to redeem the Series 2006-1 Bonds in accordance with the Projected Turbo Redemption schedule until any optional redemption of the Series 2006-1 Bonds.

Mandatory Clean-up Call .... The 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 exceed the aggregate principal amount of, and accrued interest on, all Outstanding Bonds and payments due under Swap Contracts.

Liquidity Reserve Account......... A reserve account (the "**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 $85,399,237.50 (the "**Liquidity Reserve Requirement**"). The Liquidity Reserve Requirement may be amended upon the issuance of Additional Parity Bonds. TSASC is required to maintain the Liquidity Reserve Requirement in the Liquidity Reserve Account, to the extent of available funds.

Amounts on deposit in the Liquidity Reserve Account will be available to pay interest on the Bonds, Swap Payments and Turbo Term Bond Maturities to the extent Collections are insufficient for such purpose. Any amount remaining in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement will be deposited in the Debt Service Account. Amounts in the Liquidity Reserve Account will not be available to make Sinking Fund Installments or Turbo Redemptions.

TSASC has the right to deposit a surety, guaranty or similar agreement in lieu of cash in the Liquidity Reserve Account so long as the provider thereof has a rating in the three highest rating categories by each Rating Agency.

Bond Structuring Assumptions and Methodology........................ The Series 2006-1 Bonds were structured on the basis of forecasts, which themselves are based on assumptions, as described herein. Among these are a forecast of United States cigarette consumption contained in the Global Insight Consumption Report and the application of certain adjustments and offsets to payments to be made by the PMs pursuant to the MSA, and a forecast of the Pledged TSRs, the balances in the Pledged Accounts and all earnings on amounts on deposit in the Pledged Accounts. In addition, such forecasts were used to project amounts expected to be available to make Turbo Redemptions and the resulting expected average lives of the Series 2006-1 Bonds.

No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviations from such assumptions and forecasts could materially and adversely affect the payment of the Series 2006-1 Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Distributions and Priorities........ Promptly upon receipt, the Indenture Trustee will deposit all Collections (excluding investment earnings on amounts on deposit with the Indenture Trustee under the Indenture), in an account established and maintained by the Indenture Trustee under the Indenture (the "**Collections Account**"). All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Indenture Trustee will be promptly (and, in any event, no later than the Business Day immediately preceding the next following Distribution Date) transferred to the Partial Lump Sum Payment Account. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Indenture Trustee will be promptly (and, in any event, no later than the Business Day immediately preceding the next Distribution Date) applied in the manner described under "Distribution Date Transfers" below. Not later than May 15 of each year commencing May 15, 2006, the Indenture Trustee will deposit in the Collections Account and apply as set forth under "Transfers to Accounts" below all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee in the Pledged Accounts (excluding amounts in the Partial Lump Sum Payment Account), except that all amounts in the Liquidity Reserve Account in excess of its requirement shall be transferred to the Debt Service Account, unless such excess occurs as the result of a deposit of a surety, guaranty or similar agreement in the Liquidity Reserve Account in lieu of cash, in which case any surplus will be transferred to the Unpledged TSRs Account.

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

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

"**Total Lump Sum Payment**" means 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.

"**Pledged Accounts**" are certain accounts established and maintained by the Indenture Trustee pursuant to the Indenture, including the Collections Account (except to the extent that money therein is allocable to the Operating Account, the Operating Contingency Account or the Rebate Account), the Debt Service Account, the Partial Lump Sum Payment Account, the Liquidity Reserve Account, the Turbo Redemption Account, and all subaccounts contained in the named accounts.

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

"**Swap Payment**" means any payment with respect to a Swap Contract, except that such payments shall not include any Termination Payment with respect to a Swap Contract.

"**Termination Payment**" means any payment made by TSASC with respect to a loss under or the termination of a Swap Contract, investment agreement or forward purchase agreement relating to any Account.

Transfers to Accounts. As soon as practicable, but no later than the earlier of (a) the fifth Business Day following each Deposit Date (as defined herein), or (b) the Distribution Date following each Deposit Date, the Indenture Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts as follows:

(i) to the Operating Account, an amount sufficient to cause the amount therein to equal the amount specified by an Officer's Certificate delivered with respect to the 12-month period applicable to such Officer's Certificate, to pay (a) the Operating Expenses (excluding any Termination Payments), as hereinafter defined, to the extent that the amount thereof does not exceed the Operating Cap, as hereinafter defined, and (b) the Tax Obligations, as hereinafter defined;

(ii) to the Debt Service Account an amount sufficient to cause the amount therein (taking into account any amounts on deposit in the Capitalized Interest Subaccount) to equal the sum of (a) interest on the Outstanding Bonds and all Swap Payments that will come due (1) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (2) in the then-current Bond Year, if the Deposit Date is on or after

June 1 and on or before November 30 of any Bond Year, plus (b) any such unpaid interest on the Bonds and all Swap Payments from prior Distribution Dates (including interest at the stated rate on such unpaid interest, to the extent legally permissible), provided that the amount to be deposited pursuant to this clause (ii) shall be calculated assuming that principal of the Bonds will have been paid as described in clauses (ii), (iii), (iv) and (v) under "*Distribution Date Transfers*" below;

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

(iv) unless an Event of Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement;

(v) to the Operating Contingency Account, the amount, if any, necessary to make the amount therein equal to the amount specified by the Officer's Certificate most recently delivered or deemed delivered in order to pay, for the 12-month period applicable to such Officer's Certificate, the Operating Expenses in excess of the Operating Cap or Termination Payments; and

(vi) to the Turbo Redemption Account all amounts remaining in the Collections Account.

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

"**Distribution Date**" means each June 1 and December 1, commencing June 1, 2006.

"**Operating Expenses**" means the reasonable operating expenses of TSASC (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 TSASC), legal fees and expenses of TSASC, its officers, directors 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 Indenture Trustee, including the fees and expenses of counsel to the Indenture Trustee, Termination Payments, costs incurred in order to preserve the tax-exempt status of any tax-exempt Bonds, the costs related to TSASC's or the Indenture Trustee's enforcement rights with respect to the Indenture, the TSR Purchase Agreement or the Bonds and all Operating Expenses so identified in the Indenture.

"**Operating Cap**" means (i) $1,000,000 in the Fiscal Year ending June 30, 2006, inflated in each following Fiscal Year by the greater of 3% or the percentage increase in the CPI for all Urban Consumers as published by the Bureau of Labor Statistics for the prior year, plus (ii) in each Fiscal Year, Tax Obligations specified in an Officer's Certificate.

"**Tax Obligations**" means the Rebate Requirement and any penalties, fines, or other payments required to be made to the United States of America under the arbitrage or rebate provisions of the Internal Revenue Code of 1986, as amended (the "**Code**").

"**Rebate Requirement**" will have the meaning ascribed thereto in the Tax Certificate and Agreement.

"**Tax Certificate and Agreement**" means the Tax Certificate and Agreement executed by TSASC and certain other parties at the time of issuance of Series 2006-1 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.

"**Turbo Term Bond Maturity**" means the principal payment required to be made upon the final maturity of any Series 2006-1 Bonds, as set forth in the Series Supplement.

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

Distribution Date Transfers. Unless an Event of Default has occurred, on each Distribution Date, the Indenture Trustee will apply amounts in the various funds and accounts in the following order of priority:

(i) from the Capitalized Interest Subaccount of the Debt Service Account, the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay interest on the Bonds and all Swap Payments due on such Distribution Date;

(ii) from the Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, in the following order, the Serial Maturity, if any, the Sinking Fund Installment, if any, and the Term Bond Maturities (including Turbo Term Bond Maturities), if any, due on or scheduled for such Distribution Date, plus any Serial Maturities, if any, Sinking Fund Installments and Term Bond Maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, but the amount of each Sinking Fund Installment will first be adjusted to account for prior principal payments, and the Indenture Trustee will not pay a Sinking Fund Installment pursuant to the provisions described in this clause (ii) unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date;

(iii) from the Liquidity Reserve Account first to pay the Serial Maturities, if any, and Turbo Term Bond Maturities due on or scheduled for such Distribution Date, plus any Serial Maturities, if any, and Turbo Term Bond Maturities unpaid from prior Distribution Dates and then to reimburse the provider of a surety, guaranty or other similar agreement for any payment thereunder or draw thereon for a purpose for which the Liquidity Reserve Account is otherwise available;

(iv) from the Turbo Redemption Account, to redeem Turbo Term Bonds on such Distribution Date in chronological order of Sinking Fund Installment payment dates and Turbo Term Bond Maturity Dates; and

(v) from the Partial Lump Sum Payment Account, to redeem the Series 2006-1 Bonds on such Distribution Date in chronological order of Sinking Fund Installment payment dates and Turbo Term Bond Maturity Dates, but only as directed in an Officer's Certificate delivered by TSASC and accompanied by confirmation from each Rating Agency that no rating then in effect with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended.

Upon the occurrence of any Event of Default and continuing on each succeeding Distribution Date commencing with the Distribution Date following the Event of Default, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, *first*, the accrued interest on the Bonds and all Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, *second*, principal of all Bonds then Outstanding.

Events of Default........................ The occurrence of any of the following events will constitute an "**Event of Default**" on the Bonds under the Indenture: (i) TSASC fails to pay when due any Serial Maturity, if any, or Turbo Term Bond Maturity of, or interest on, any Bond or any Swap Payment; (ii) failure of TSASC to observe or perform any other covenant, condition, agreement, or provision contained in the Bonds or the Indenture 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 (iii) 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 (ii) or (iii) 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.

Failure to make any Projected Turbo Redemption or any Sinking Fund Installment does not constitute an Event of Default to the extent that such failure results from the insufficiency of available Collateral.

Additional Parity Bonds............ Additional Bonds may be issued under the Indenture to refund all Bonds in whole. Additional Bonds may also be issued under the Indenture to refund Bonds in part or for any other purpose but only if upon the issuance thereof: (A) the amount on deposit in the Liquidity Reserve Account following the issuance of the additional Bonds will be at least equal to the Liquidity Reserve Requirement; (B) no Event of Default shall have occurred; (C) the expected weighted average life of each Bond that will remain Outstanding after the date of issuance of the additional Bonds as computed 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 Bond as computed on the basis of new projections assuming that no such additional Bonds are issued plus (y) one year; (D) Rating Confirmation is received for any Bonds which are then rated by a Rating Agency that will remain Outstanding after the date of issuance of the additional Bonds; and (E) the definition of Pledged TSRs is amended to take into account the revised calculations pursuant to clause (C) above. Additional Bonds issued under this paragraph are referred to herein as "**Additional Parity Bonds**".

Subordinate Bonds..................... Subordinate bonds may be issued for any purpose by TSASC if there is no payment permitted for such bonds until all then outstanding Bonds are Fully Paid. Subordinate bonds may be issued without satisfying the requirements of the Indenture relating to Additional Parity Bonds.

Covenants .... Both TSASC and the City have made certain covenants for the benefit of the Bondholders. See "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 Series 2006-1 Bonds address only (i) the payment of interest on the Series 2006-1 Bonds when due, and (ii) the payment of principal of the Series 2006-1 Bonds by their respective Turbo Term Bond Maturity Dates. The ratings do not address the payment of Sinking Fund Installments on Series 2006-1 Bonds or Turbo Redemptions. The Turbo Term Bond Maturities of the Series 2006-1 Bonds were structured to produce cash flow stress test performance necessary for TSASC to achieve the targeted credit ratings. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time. See "RATINGS" herein.

Risk Factors................................. Reference is made to "RISK FACTORS" herein for a description of certain considerations relevant to an investment in the Series 2006-1 Bonds.

Legal Considerations .... Reference is made to "LEGAL CONSIDERATIONS" herein for a description of certain legal issues relevant to an investment in the Series 2006-1 Bonds.

Tax Matters .... 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, interest on the Series 2006-1 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "**Code**") and is excluded from New York adjusted gross income for purposes of personal income taxes imposed by the State and any political subdivision thereof (including the City), to the extent that such interest is excluded from gross income for federal income tax purposes. Transaction Counsel is of the further opinion that interest on the Series 2006-1 Bonds is 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 tax consequence related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006-1 Bonds. See "TAX EXEMPTION AND OTHER TAX MATTERS".

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, 21W, New York, NY 10286. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This

Offering Circular is not to be construed as a contract or agreement among TSASC, the City and the Bondholders.

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$1,353,510,000
TSASC, INC.
Tobacco Settlement Asset-Backed Bonds, Series 2006-1

PLAN OF FINANCE

TSASC has previously issued pursuant to the Indenture (i) its Tobacco Flexible Amortization Bonds, Series 1999-1, of which $662,935,000 are outstanding, (ii) its Tobacco Settlement Asset-Backed Bonds, Series 2002-1, of which $447,035,000 are outstanding, and (iii) certain parity bonds issued to represent the obligation to repay principal and interest on a loan extended to TSASC by the United States Department of Transportation, of which $158,940,743 is outstanding (items (i), (ii) and (iii), collectively, the "**Refunded Bonds**"). TSASC will apply a portion of the proceeds from the sale of the Series 2006-1 Bonds to retire the Refunded Bonds or to establish an irrevocable escrow to refund the Refunded Bonds. Such escrowed proceeds of the Series 2006-1 Bonds will be deposited with The Bank of New York, as escrow agent (the "**Refunding Escrow Agent**") pursuant to an Escrow Agreement dated as of February 1, 2006 (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 in direct obligations of the United States Government, the principal of and interest on which, when received, will be sufficient to pay the principal or redemption price of and interest on the Refunded Bonds upon maturity or redemption thereof. See also "VERIFICATION OF MATHEMATICAL COMPUTATIONS."

In connection with the refunding of the Refunded Bonds, certain TSRs which had accumulated in a trapping account under the Indenture and which, while so held in such account, were pledged to secure the Refunded Bonds will be released to TSASC free and clear of the lien of the Indenture.

RISK FACTORS

Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2006-1 Bonds as well as other information contained in this Offering Circular. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2006-1 Bonds and does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2006-1 Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2006-1 Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value or the liquidity of the Series 2006-1 Bonds or in certain circumstances, could result in a complete loss of a Bondholder's investment. There can be no assurance that other risk factors will not become material in the future.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

MSA Litigation. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, and other parties have instituted lawsuits against various tobacco manufacturers, including the PMs, as well as against certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws. Some actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed and may be filed in the future alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. To date, such challenges have not been ultimately successful. The terms of the MSA are currently being challenged and may continue to be challenged in the future. Certain pending challenges to the MSA are described below under "—*Freedom Holdings, Grand River* and Related Cases." A determination that the MSA or related state legislation is void or unenforceable would have a material adverse effect on the payments by the PMs under the MSA and the amount or the timing of receipt of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds and could result in the complete loss of a Bondholder's investment. See "LEGAL CONSIDERATIONS" herein.

Qualifying Statute and Related Legislation. Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. See "− Other Potential Payment Decreases Under the Terms of the MSA−NPM Adjustment" herein and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT−MSA Provisions Relating to Model/Qualifying Statutes" herein. A Settling State may avoid the effect of this adjustment by adopting and diligently enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute, which by definition is a Qualifying Statute under the MSA. The Model Statute, in its original form, required an NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM and further authorized the NPM to obtain from the applicable Settling State the release of the amount by which the escrow deposit in that state exceeded that state's allocable share of the total payments that the NPM would have made as a PM. Legislation has been enacted in at least 44 of the Settling States, including the State, amending the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the statute to the excess above the total payment that the NPM would have paid had it been a PM (each an "**Allocable Share Release Amendment**"). A majority of the PMs, including all OPMs, have indicated in writing that the State's Model Statute, as amended, will continue to constitute a Qualifying Statute within the meaning of the MSA

In addition, more than 44 Settling States (including the State) have passed, and various states are considering, legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making required escrow payments under the states' respective Qualifying Statutes. Pursuant to the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold directly or indirectly in the State is required to certify annually that it is either (a) a PM and is in full compliance with the terms of the MSA or (b) an NPM and is in full compliance with the State's Qualifying Statute. The Qualifying Statutes and related legislation (including those of the State), like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the United States Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in the State and certain other states. Appeals are also possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Pending challenges to the Qualifying Statutes and related legislation are described below under "—*Freedom Holdings, Grand River* and Related Cases" and "Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation" in this subsection.

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

A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, target sales in states without Allocable Share Release Amendments, and thereby potentially increase their market share at the expense of the PMs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — MSA Provisions Relating to Model/Qualifying Statutes" herein.

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

Freedom Holdings, Grand River and Related Cases. Among the pending challenges to the MSA and related statutes are two lawsuits, *Freedom Holdings v. Spitzer* and *Grand River Enterprises Six Nations Ltd. v. Pryor*, which are pending against the State in the United States District Court for the Southern District of New York (the "**Southern District**"). The lawsuits allege, among other things, that the MSA and related statutes create an unlawful output cartel under federal antitrust law and are thus preempted by federal law. *Freedom Holdings* and *Grand River* have survived motions to dismiss for failure to state a claim upon which relief can be granted and are in the discovery phase of litigation in preparation for the development of a factual record to support possible findings of fact that may be used by the court in deciding whether the MSA and/or related statutes are void and unenforceable. To date, *Freedom Holdings* and *Grand River* are the only cases challenging the MSA or related statutes that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact as to the operation and impact of the MSA and the related statutes.

In addition, certain decisions by the United States Court of Appeals for the Second Circuit (the "**Second Circuit**") in *Freedom Holdings* have created heightened uncertainty as a result of the court's interpretation of federal antitrust law immunity doctrines, as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts that have rejected challenges to the MSA. Prior decisions in other federal courts have rejected such challenges, concluding that the MSA and related statutes are protected from an antitrust challenge in reliance on either the "state action" immunity doctrine (based on a United States Supreme Court case known as "***Parker***"), or the First Amendment based immunity doctrine (based on United States Supreme Court cases known as "***Noerr-Pennington***"). The applicability of the *Parker* immunity doctrine requires two levels of analysis. Where a state confers authority on private parties to engage in conduct that would otherwise be *per se* violative of antitrust laws, cases subsequent to *Parker* (most notably a United States Supreme Court case known as "***MidCal***") have required, for *Parker* immunity to apply, both a clear articulation of state policy and active supervision by the state of the otherwise anticompetitive conduct. When a state is acting unilaterally in its capacity as the sovereign, however, no *MidCal* analysis is required and *Parker* immunity applies directly. In *Freedom Holdings*, the Second Circuit determined, on the limited record before it, that a *MidCal* analysis was required and, on that record, found insufficient active supervision by the State and insufficient articulation of State policy to support a conclusion that there was antitrust immunity under *Parker*.

On April 16, 2002, in *Freedom Holdings,* certain cigarette importers challenged the State's Complementary Legislation, alleging in their initial complaint that the State's Complementary Legislation enforces a market-sharing and price-fixing cartel which allows the OPMs to charge supra-competitive prices for their cigarettes. Plaintiffs also alleged that the State's Complementary Legislation violates the Commerce Clause of the U.S. Constitution and establishes an output cartel in violation of federal antitrust law. The initial complaint further alleged that the legislation is being selectively enforced in violation of the Equal Protection Clause of the United States Constitution. The Southern District dismissed the action on May 14, 2002. The Southern District held, among other things, that the State's Complementary Legislation was protected from antitrust challenge by both direct *Parker* immunity and *Noerr-Pennington* immunity. The plaintiffs appealed, and on January 6, 2004, the Second Circuit partially reversed the decision of the Southern District.

In its reversal, the Second Circuit in *Freedom Holdings* noted, because it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint, and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit affirmed the Southern District's dismissal of that portion of the complaint that alleged a Commerce Clause violation. The Second Circuit reversed the dismissal of the plaintiffs' Equal Protection claim, based on allegations that the State's Complementary Legislation is not applied to the sale of cigarettes by wholesalers or importers located on Native American Reservations located in the State, and allowed the plaintiffs to amend their complaint to correct deficiencies in the pleadings. With regard to the plaintiffs' antitrust claims, the Second Circuit held that the plaintiffs had alleged facts sufficient to state a claim that the State's Complementary Legislation violates federal antitrust law and that, based on the facts alleged, the legislation was not protected from an antitrust challenge based on either of the *Parker* or *Noerr-Pennington* immunity doctrines. The Second Circuit determined, on the record before it, that a *MidCal* analysis was required and, on that record, found both insufficient active supervision and insufficient articulation of state policy. On March 25, 2004, the Second Circuit denied the State's petition for a rehearing.

In April and November 2004, the plaintiffs in *Freedom Holdings* filed amended complaints in which the plaintiffs now seek (i) a declaratory judgment that the operation of the MSA, the State's Qualifying Statute and the State's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and are thus preempted by federal antitrust law and (ii) an injunction permanently enjoining the enforcement of the State's Qualifying Statute and the State's

Complementary Legislation. The amended complaint does not seek an injunction enjoining the enforcement or administration of the MSA, is limited only to claims under the federal antitrust laws, and does not allege that the MSA, the State's Qualifying Statutes or the State's Complementary Legislation violate the Commerce Clause or the Equal Protection Clause of the United States Constitution.

On September 14, 2004, the Southern District denied the plaintiffs' motion for a preliminary injunction enjoining the State during the pendency of the action from enforcing the MSA, the State's Qualifying Statute and the State's Complementary Legislation. The Southern District held that, based on the evidence presented by the parties, plaintiffs had failed to establish a likelihood of success on the merits of their claims that (i) the State's Qualifying Statute and the State's Complementary Legislation constituted a *per se* violation of the federal antitrust laws or, (ii) the MSA, the State's Qualifying Statute and the State's Complementary Legislation would not be entitled to *Parker* antitrust immunity under a *MidCal* analysis. The Southern District also determined that the plaintiffs had failed to make a showing of irreparable harm sufficient to justify preliminary injunctive relief. The Southern District, however, granted the plaintiffs' motion to enjoin the State from enforcing the State's Allocable Share Release Amendment, holding that plaintiffs had established a likelihood of success on their claim that the State's Allocable Share Release Amendment violates the federal antitrust laws, and that its enforcement would cause plaintiffs and other NPMs irreparable harm. Plaintiffs appealed the Southern District's denial of their motion for a preliminary injunction as to the State's Qualifying Statute and State's Complementary Legislation. The plaintiffs did not appeal the denial of their motion to enjoin enforcement of the MSA, nor did the State appeal the granting of the plaintiffs' motion to enjoin enforcement of the State's Allocable Share Release Amendment. On May 18, 2005, the Second Circuit affirmed the Southern District's denial of the plaintiffs' request for a preliminary injunction. The Second Circuit held that the plaintiffs failed to satisfy the irreparable harm requirement for a preliminary injunction. The Second Circuit made no determination as to the likelihood of the plaintiffs' ultimate success on the merits of their claims. On November 1, 2005, the Southern District denied, without prejudice and upon agreement of the parties, plaintiffs' motion for partial summary judgment which sought a determination that the State's Allocable Share Release Amendment violates federal antitrust law. On December 28, 2005, the Southern District denied the plaintiffs' motion to file an amended complaint to add a Commerce Clause claim similar to the plaintiffs' claims in *Grand River*, as described below. In its decision, however, the Southern District granted the plaintiffs leave to renew their motion to amend upon the condition that the plaintiffs show what additional discovery would be required to support such additional claims.

The State is within the jurisdiction of the Second Circuit and an adverse decision by the Second Circuit as to the enforceability of the MSA and/or related statutes under federal antitrust law would therefore be controlling law within the State from which no appeal as of right to the United States Supreme Court exists. No assurance can be given that the Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Freedom Holdings*. A decision adverse to the State in the Second Circuit could, unless stayed pending appeal at the discretion of the court, result in the complete cessation of the Pledged TSRs in the Second Circuit during the pendency of the appeal.

On July 1, 2002, the *Grand River* case was commenced in the United States District Court of the Southern District of New York by certain NPMs against current and former attorneys general of 31 states (the "**Grand River Defendant States**")[*]. The plaintiffs seek to enjoin the enforcement of the Grand River Defendant States' Qualifying Statutes and Complementary Legislation, alleging that such Qualifying Statutes and Complementary Legislation violate the plaintiffs' constitutional rights under the

[*] The Grand River Defendant States are: Alabama, Alaska, Arizona, California, Colorado, Delaware, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, New York, North Carolina, Ohio, Oregon, South Carolina, South Dakota, Tennessee, Washington, Wisconsin and Wyoming.

Commerce Clause and other provisions of the U.S. Constitution and also that such Qualifying Statutes and Complementary Legislation conflict with and are therefore preempted by the federal antitrust laws. In September 2003, the District Court held that it lacked personal jurisdiction over the non-New York attorneys general and dismissed the plaintiffs' complaint against them. In addition, the District Court dismissed the plaintiffs' complaint against the New York Attorney General, finding that the plaintiffs had failed to state a claim. After the Second Circuit's decision in *Freedom Holdings* (discussed above), however, the District Court granted the plaintiffs' motion in *Grand River* to reinstate, against the New York Attorney General only, that portion of the complaint alleging that New York's Qualifying Statute and New York's Complementary Legislation conflict with antitrust laws and are preempted by federal law.

The plaintiffs appealed the dismissal of their other claims to the Second Circuit. On September 28, 2005, the Second Circuit reinstated the Commerce Clause challenge and reinstated the non-New York attorneys general as defendants, finding that a federal court in New York could exercise personal jurisdiction over them, and affirmed the dismissal of certain remaining claims, including the claim that the Qualifying Statute and related legislation violated the Indian Commerce Clause of the U.S. Constitution. The case was remanded to the District Court and remains pending. On October 12, 2005, the defendants filed a petition with the Second Circuit for rehearing with regard to the Second Circuit's ruling on the issue of personal jurisdiction. The plaintiffs have filed a petition with the Second Circuit for rehearing on the Indian Commerce Clause ruling.

In its decision, the Second Circuit found that the extensive negotiations by the Settling State defendants over the MSA and the related statutes that took place in the State, and the MSA's ultimate execution in the State, constituted transacting business under the State's law and that therefore the initial requirement for a finding of personal jurisdiction in the State was satisfied. The Second Circuit further found that because the plaintiffs' surviving antitrust claim challenged the MSA and not just the related statutes, there was a sufficient nexus between the negotiations and the signing of the MSA that took place in the State and plaintiffs' antitrust claim to find personal jurisdiction over all of the Grand River Defendant States.

With regard to the Commerce Clause challenge, the Second Circuit noted that because it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit held that although each state's Qualifying Statute and Complementary Legislation apply to cigarette sales within such state, the plaintiffs sufficiently stated a possible claim that these statutes together create a national or "interstate" regulatory policy and thereby exert "extraterritorial control" over out-of-state transactions in contravention of the Commerce Clause. The Second Circuit acknowledged that in *Freedom Holdings* (discussed above) it had ruled that plaintiffs failed to state a claim that the State's Complementary Legislation had violated the Commerce Clause, but explained that it did so because plaintiffs there had not sufficiently alleged an extraterritorial effect of that legislation. To date, *Grand River* is the only case in which a Commerce Clause challenge to the MSA and related statutes has survived a motion to dismiss. An adverse ruling on Commerce Clause grounds could potentially lead to invalidation of the MSA and the Qualifying Statutes in their entirety and result in the complete loss of a Bondholder's investment.

A final decision in *Grand River* by the District Court would be subject to appeal as of right to the Second Circuit. However, any decision by the Second Circuit in this case would be controlling law within the State from which no appeal as of right to the United States Supreme Court exists. No assurance can be given that the Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Grand River*. A decision adverse to the State in the Second Circuit could unless stayed pending appeal at the discretion of the court, result in a complete cessation of the Pledged TSRs in the Second Circuit during the pendency of the appeal.

Freedom Holdings and *Grand River* remain pending in the Southern District and the court has ordered the *Freedom Holdings* plaintiffs and the State to proceed with discovery with respect to the antitrust claim and the *Grand River* plaintiffs and the defendant Settling States to proceed with discovery with respect to the antitrust and Commerce Clause claims.

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

On March 28, 2005, the District Court for the Northern District of California in the California case, *Sanders v. Lockyer*, dismissed an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State of California and the OPMs. The District Court found the MSA to be the sovereign act of the State of California and further found California's Qualifying Statute and Complementary Legislation to be direct legislative activity entitled to *Parker* immunity without the need for any additional *MidCal* analysis. The District Court also found the MSA and California's Qualifying Statute and Complementary Legislation to be entitled to *Noerr-Pennington* immunity. The plaintiffs have appealed the dismissal to the Ninth Circuit Court of Appeals. The plaintiff's opening appellate brief was filed on August 19, 2005, and the defendant's brief was filed on October 20, 2005.

Two cases are currently pending in Louisiana that challenge the MSA, Qualifying Statutes and related legislation. In *Xcaliber International Limited, LLC v. Ieyoub*, certain NPMs have challenged the state's Allocable Share Release Amendment on both federal and state constitutional grounds. This action was dismissed by the District Court in February 2005 and the plaintiffs have appealed the dismissal to the Fifth Circuit Court of Appeals. In *Coker v. Foti*, filed in August 2005, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana, seeking, among other relief, (i) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid under the Interstate Compact Clause of the United States Constitution and that Louisiana's Qualifying Statute and Complementary Legislation are preempted by the federal antitrust laws; and (ii) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. On November 2, 2005 the state defendants filed a motion to dismiss the complaint.

In the Oklahoma case, *Xcaliber International Limited, LLC v. Edmondson*, certain NPMs have challenged Oklahoma's enforcement of its Allocable Share Release Amendment under federal antitrust laws. On May 20, 2005, the District Court granted summary judgment in favor of defendant, holding that the Oklahoma Allocable Share Release Amendment constituted unilateral state action that is directly protected from preemption by the *Parker* immunity doctrine. The plaintiffs have requested that the District Court reconsider its summary judgment order and appealed the order to the United States Court of Appeals for the Tenth Circuit. On August 31, 2005, the District Court denied the motion to reconsider. On October 28, 2005, the Tenth Circuit referred the case for mediation conferencing.

In the Kentucky case, *Tritent International Corp. v. Commonwealth of Kentucky*, the plaintiffs seek a declaratory judgment that Kentucky's Qualifying Statute and Complementary Legislation conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On September 8, 2005, the District Court granted Kentucky's motion to dismiss the complaint and on October 24, 2005, the District Court denied the plaintiffs' subsequent motion for reconsideration. The plaintiffs have appealed the dismissal to the Sixth Circuit Court of Appeals.

Similarly, in the Tennessee case, *S&M Brands, Inc. v. Summers*, the plaintiffs seek a declaratory judgment that Tennessee's Qualifying Statute (including the Allocable Share Release Amendment) and Complementary Legislation also conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On June 1, 2005, the Sixth Circuit affirmed the District Court's denial of plaintiffs' motion for a preliminary injunction with respect to the enforcement of Tennessee's Allocable Share Release Amendment. On October 6, 2005, the District Court granted Tennessee's motion to dismiss the complaint except that portion of the complaint that alleges that the state's retroactive enforcement of the state's Allocable Share Release Provision violates plaintiff's constitutional rights, which issue was not raised by the state in its motion and was therefor not addressed by the court. The District Court held that Tennessee's Qualifying Statute and Complementary Legislation were direct state action, entitled to *Parker* immunity without the need for *MidCal* analysis. By decision filed November 28, 2005, the District Court held that the state's retroactive application of its Allocable Share Release Amendment, which was effective as of April 20, 2004, to 2003 cigarette sales was unconstitutional.

Two cases are currently pending in Arkansas. In the first case filed, *Grand River Enterprises Six Nations Ltd. v. Beebe*, the plaintiffs seek to enjoin preliminarily and permanently Arkansas' enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in *Freedom Holdings*. Arkansas' motion to dismiss the complaint remains pending in the District Court. In the second case, *International Tobacco Partners Ltd. v. Beebe*, the plaintiffs seek a declaratory judgment that the MSA and Arkansas' Qualifying Statute, Complementary Legislation and Allocable Share Release Amendment are preempted by federal antitrust laws and certain provisions of the U.S. Constitution. Arkansas' motion to dismiss the complaint remains pending with the District Court. The District Court has, however, as against the plaintiffs only, preliminarily enjoined the enforcement of Arkansas' Allocable Share Release Amendment. On August 8, 2005, the court ordered Arkansas to reimburse certain amounts it withheld pursuant to the Allocable Share Release Amendment to International Tobacco.

Two cases are currently pending in Kansas. In the first case filed, *Xcaliber International Limited, LLC v. Kline*, the plaintiffs seek to enjoin preliminarily and permanently Kansas' enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in the *Freedom Holdings* case in New York. The complaint challenges only the Allocable Share Amendment but purports to reserve the right to challenge the Kansas Qualifying Statute in its entirety. The plaintiff's motion for preliminary injunction and Kansas' motion to dismiss the complaint remain pending in the District Court. In the second case, *International Tobacco Partners Ltd. v. Kline*, the plaintiffs seek a declaratory judgment that the Allocable Share Release Amendment is preempted by federal antitrust laws and certain provisions of the U.S. Constitution and preliminary and permanent injunctions against the enforcement of the Allocable Share Release Amendment. Although the complaint asserts that the MSA and Kansas' Qualifying Statute are also preempted by federal antitrust laws and certain provisions of the U.S. Constitution, it does not specifically seek to enjoin the enforcement thereof.

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

If there is an adverse ruling in one or more of the cases discussed above, it could have a material adverse effect on the amount of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds and could result in the complete loss of a Bondholder's investment. For a description of the opinions of Transaction Counsel addressing such matters, see "LEGAL CONSIDERATIONS—MSA Enforceability" and "LEGAL CONSIDERATIONS—Qualifying Statute Constitutionality" herein.

Litigation Seeking Monetary Relief from Tobacco Industry Participants

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke ("**ETS**"), also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of September 30, 2005, there were 13 cases on appeal in which verdicts were returned against Philip Morris, including a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. On December 15, 2005, however, the Illinois Supreme Court reversed the judgment against Philip Morris and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the United States. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. It has been reported that the plaintiffs have filed a motion asking the court to reconsider its decision. It is possible that the plaintiffs will seek further appeals and/or rehearings. No assurance can be given that that such appeals and/or rehearings will not be granted or that they will not be decided in the plaintiffs' favor.

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

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins, (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) healthcare cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for healthcare expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement, or one or more adverse judgments could result in a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the Global Insight Consumption Report. The financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs and/or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA, and have a material adverse effect on the amount of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds. For a detailed discussion of tobacco industry litigation and related matters, see "DOMESTIC TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS."

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

Smoking Trends. As discussed in the Global Insight Consumption Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to an estimated 393 billion cigarettes in 2004. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The Global Insight Consumption Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.78% to 199 billion cigarettes in 2042 under its Base Case Forecast (as defined herein), which represents a decline in per capita consumption at an average rate of 2.55% per year. These consumption declines are based on historical trends which may not be indicative of future trends, as well as other factors which may vary significantly from those assumed or forecasted by Global Insight.

According to the Global Insight Consumption Report, the pharmaceutical industry is seeking approval from the U.S. Food and Drug Administration (the "**FDA**") for two new smoking cessation products possibly more effective than those now in existence such as gum and patch nicotine replacement products, and other smoking cessation products such as NicoBloc or Zyban. Varenicline, a Pfizer product, is a smoking cessation pill containing a product that binds to brain nicotine receptors and is intended to satisfy nicotine cravings without being pleasurable or addictive, and Acomplia, a Sanofi-Synthelabo product, is mainly a weight reduction pill, but also contributes to smoking cessation. The FDA has granted a priority review of Pfizer and its product, Varenicline, implying an approval decision within six months. Two companies are also seeking FDA approval for vaccines to prevent and treat nicotine addiction. One of these companies, Cytos Biotechnology AG, announced on May 14, 2005 that it had successfully completed Phase II testing of a virus-based vaccine, which is genetically engineered to cause an immune system response from nicotine. The company now plans to begin Phase III trials. One NPM has also introduced a cigarette with reportedly little or no nicotine. Future FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels. Such new products or similar products, if successful, or such FDA regulation, if enacted, could have a material adverse effect on cigarette consumption.

A decline in the overall consumption of cigarettes beyond the levels forecasted in the Global Insight Consumption Report could have a material adverse effect on the payments by PMs under the MSA and the amounts of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Bonds or premiums, if any, due thereon.

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. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the FDA, amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with broad authority to regulate tobacco products. Philip Morris has indicated its strong support for this legislation. FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels.

Cigarettes are also currently subject to substantial excise taxes in the United States. The federal excise tax per pack of 20 cigarettes is $0.39 as of November, 2005. All states, the District of Columbia and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.46 per pack in Rhode Island. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City. According to the Global Insight Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states in 2005. The population-weighted average state excise tax as of December, 2005 was $0.913 per pack. In 2006 at least eight states are considering proposed excise tax increases, including a $1.00 increase outside of the City in a budget proposal by the Governor of the State. In addition, the Mayor of the City has proposed a $0.50 increase within the City.

According to the Global Insight Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in ten states and a few large cities. California imposed comprehensive statewide smoking bans in 1998 and banned smoking in its prisons effective July 1, 2005. Delaware banned smoking in all indoor public areas in 2002. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Also in 2003, Connecticut, Maine, and Florida passed laws which ban smoking in restaurants and bars. Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. Since then Massachusetts, Montana, Rhode Island, and Vermont have established similar bans. Voters in Washington State passed a ballot initiative in November 2005 which bans smoking in all public places effective January 2006. The restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. In January 2006, New Jersey adopted a comprehensive ban which will go into effect in April 2006. At the same time New Jersey increased the minimum legal age to purchase cigarettes from 18 to 19 years. Three states, Alabama, Alaska, and Utah, also set the minimum age at 19. In December 2005 Chicago passed a smoking ban which also applies within 15 feet of entrances to restaurants and other public places. It went into effect in January 2006, with an exemption for bars until July 2008. Also in January the District of Columbia enacted an extensive ban which will be fully in effect January 2007. It is expected that these restrictions will continue to proliferate. In 2006 at least five states, Arkansas, Colorado, Iowa, Maryland and Utah, are considering comprehensive bans. On January 26, 2006 the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant. The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of January 3, 2006, there were 2,129 municipalities in the U.S. with indoor smoking restrictions.

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

No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes. Excise tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. As a result of these types of initiatives and other measures, the overall consumption of cigarettes nationwide may decrease materially more than forecasted in the Global Insight Consumption Report and thereby could have a material adverse effect on the payments by PMs under the MSA and the amounts of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds. See "DOMESTIC TOBACCO INDUSTRY – Regulatory Issues" herein.

Other Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments. The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which may be material. Such adjustments, offsets and recalculations could reduce the Pledged TSRs available to TSASC below the respective amounts required to pay principal of and interest on the Series 2006-1 Bonds. The State has advised TSASC that both the Settling States and one or more of the PMs are disputing or have disputed the calculations of the Initial Payments for 2000 through 2003 and the Annual Payments for 2000 through 2005. No assurance can be given as to the magnitude of the adjustments, if any, that may result upon resolution of those disputes. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

The assumptions used to project Collections (the source of the payments on the Series 2006-1 Bonds) are based on the premise that certain adjustments will occur as set forth under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." herein. Actual adjustments could be materially different from what has been assumed and described herein.

Growth of NPM Market Share and Other Factors. The assumptions used to project Collections and structure the Bonds contemplate declining consumption of cigarettes in the United States combined with a static relative market share of 6.2%[*]. for the NPMs. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. Should the forecasted decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment.

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM

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[*] The aggregate market share of NPMs utilized in the bond structuring assumptions may differ materially from the market share information utilized by the MSA Auditor when calculating the NPM adjustments.

would have been required to make had it been a PM. At least 44 Settling States, including the State, have enacted, and other states are considering, legislation that amends this provision in their Model/Qualifying Statutes, by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM (so called "**Allocable Share Release Legislation**"). The National Association of Attorneys General ("**NAAG**") has endorsed these legislative efforts. A majority of the PMs, including all OPMs, have indicated their agreement in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Release Legislation, such Settling State's previously enacted Model Statute or Qualifying Statute will continue to constitute a Model Statute or Qualifying Statute within the meaning of the MSA. Following the challenge by NPMs in *Freedom Holdings*, the United States District Court for the Southern District of New York in September 2004 enjoined New York from enforcing its Allocable Share Release Legislation. NPMs are also currently challenging Allocable Share Release Legislation in Arkansas, California, Kansas, Kentucky, Louisiana, Oklahoma and Tennessee. It is possible that NPMs will challenge such legislation in other states. See "—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. To the extent either (i) that other states do not enact or enforce Allocable Share Release Legislation or (ii) that a state's Allocable Share Release Legislation is invalidated, NPMs could concentrate sales in such states to take advantage of the absence of Allocable Share Release Legislation by limiting the amount of its escrow payment obligations to only a fraction of the payment it would have been required to make had it been a PM. Because the price of cigarettes affects consumption, NPM cost advantage is one of the factors that has resulted and could continue to result in increases in market share for the NPMs.

A significant loss of market share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and the amounts of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - Adjustments to Payments" and "GLOBAL INSIGHT CONSUMPTION REPORT" herein.

NPM Adjustment[*]. The NPM Adjustment, measured by domestic sales of cigarettes by NPMs, is designed to reduce the payments of the PMs under the MSA to compensate the PMs for losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997 (a condition that has existed for every year since 2000), (2) a nationally recognized economic firm 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 Settling States and the PMs have selected The Brattle Group as the economic consultants that will be responsible for making the "significant factor" determination.

The State's Attorney General's office has stated that the State has been and is diligently enforcing its Qualifying Statute.

The NPM Adjustment is applied to the subsequent year's Annual Payment due to those Settling States that have been proven to have not diligently enforced their Model Statutes. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**" If the PMs' actual aggregate market share is between 0% and 16⅔% less

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

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 16⅔%, the NPM Adjustment will be calculated as follows:

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

In June 2003, the OPMs and the Settling States settled all NPM Adjustment claims for the years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of an OPM's right to an NPM Adjustment for the years 2001 and 2002. In connection therewith, the OPMs and the Settling States agreed prospectively that OPMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment unless and until the selected economic consultants, The Brattle Group, determine that the disadvantages of the MSA were a significant factor contributing to the market share loss giving rise to the alleged NPM Adjustment (the SPMs have not agreed to await such a determination). A Bondholder should assume that if the selected economic consultants make such a "significant factor" determination regarding a year for which one or more OPMs have claimed an NPM Adjustment, such OPMs will either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. Each of the three OPMs has notified the Settling States that, in connection with the market share loss for calendar year 2003, it is seeking an NPM Adjustment. It is expected that the economic consultants will make a final determination for 2003 prior to the due date for the 2006 Annual Payment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" herein.

The State has indicated that the 2005 Annual Payments by the OPMs were made without the diversion of any portion thereof into the Disputed Payments Account for the Settling States. According to the State, however, eleven SPMs did pay approximately $84 million of their 2005 Annual Payments into the Disputed Payments Account for the Settling States as a result of alleged disputes, including disputes related to NPM Adjustments. Of this $84 million, approximately $44 million represented payments by six SPMs relating to the 2003 Annual Payment. Following litigation brought by the State challenging such actions, the six SPMs released such $44 million to the Settling States. Such release of money, however, does not represent final settlement of any alleged disputes. In addition, more than $18 million due from various SPMs was not paid on April 15, 2005. The States of Kentucky, Montana and Vermont have also indicated that they expect OPMs, alleging disputes related to the NPM Adjustment, to divert a portion of their future MSA payments into the Disputed Payments Account. Those three states, reporting that the PMs experienced a decline in market share of 6.2% in 2003, assumed an NPM Adjustment of 18.6% in projecting their fiscal 2006 and 2007 MSA payments for budgetary purposes. The State has received no indication from the PMs whether or not they currently plan to pay or not pay future Annual Payments into the Disputed Payments Account or whether or not they expect to withhold payment.

In general, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. As noted above, the State's Attorney General's office has stated that the State has been and is diligently enforcing its Qualifying Statute. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a State has diligently enforced its Qualifying Statute or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. On August 3, 2005, a Connecticut state court ruled that certain issues relating to the calculation of an NPM Adjustment are subject to arbitration pursuant to the terms of the MSA. See *State of Connecticut v. Philip Morris, Inc.* The case involved a claim by certain SPMs that the MSA Auditor, selected by the parties to the MSA to determine payments under the MSA, miscalculated their annual payments for shipment year 2003 by refusing to reduce the amounts by applying the NPM Adjustment. In the decision, the court held that a challenge to the MSA Auditor's determination that the MSA forbids the application of the NPM Adjustment to payments owed by PMs for any year in which all Settling States had Qualifying Statutes in full force and effect is subject to arbitration. The MSA provides that the arbitration shall be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. The court's determination is contrary to the determination by a New York State court that concluded that such issues were not subject to arbitration under the MSA. See *The State of New York v. Philip Morris Incorporated*. The Connecticut court's decision has been appealed by the State of Connecticut and the New York Court's decision has been appealed by the SPMs that filed the motion to compel arbitration. Neither decision addressed whether or not a diligent enforcement dispute itself would be resolved in state courts or through arbitration, although the Connecticut court did state in dicta that such a dispute was arbitrable.

In January 2002 B&W disputed the recalculation of the Annual Payments due in 2000 and 2001, claiming that the MSA Auditor relied upon inappropriate data in calculating B&W's market share and that a larger NPM Adjustment should have been applied to the 2001 payment because a majority of the Settling States were not diligently enforcing their Qualifying Statutes in 2000. Although this dispute was resolved in April 2002, other disputes regarding the diligent enforcement of Qualifying Statutes by the Settling States may be expected in the future if the market share of the NPMs increases and results in a correspondingly large NPM Adjustment that, absent the protection of the Qualifying Statutes, could apply.

In February 2002, B&W sent a letter addressed to the Settling States requesting information relating to the enforcement of their applicable Qualifying Statute. In November 2003, six SPMs sent a letter to NAAG and the Attorneys General of the Settling States, which is intended to provide notice that such SPMs may initiate litigation or arbitration proceedings relating to the MSA. The MSA requires a party to provide at least 30 days' prior written notice to the other parties before initiating a proceeding to enforce the MSA or alleging breaches of the MSA. Among other things, such SPMs alleged that the NPM Adjustment is not working as designed to ensure that SPMs are not penalized by becoming signatories to the MSA. They also alleged that the Market Share Loss recorded by the MSA Auditor is significantly smaller than the Market Share Loss that actually exists and that the Model Statute has not been diligently enforced or that in states where it is diligently enforced, does not contain efficient and effective enforcement mechanisms. The SPMs specifically request in their letter to continue to discuss possible resolution of these issues with the other parties to the MSA. The letter does not specify what type of relief would be sought in any litigation or arbitration proceedings. In March, 2005, the OPMs filed a Freedom of Information Act request with the State seeking information pertaining to the State's efforts to identify NPMs and to enforce its Qualifying Statute. The State believes that nearly identical requests were sent to substantially all of the other Settling States.

In addition, at least 44 Settling States, including the State, have passed, and various states are considering, legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making required escrow payments under the Qualifying Statutes. Under the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold, directly or indirectly, in the State is required to certify annually that it is either a PM or, if an NPM, that it is in full compliance with the State's Qualifying Statute. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the State's Complementary Legislation, and such cigarettes can be seized and are subject to forfeiture. The State's

Qualifying Statute and Complementary Legislation, along with similar legislation in thirty other states, have been challenged in the State by a group of NPMs on various constitutional grounds, including claims based on preemption by the federal antitrust laws. See "Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

All of the OPMs and other PMs have provided written assurances that the Settling States have no duty to enact Complementary Legislation, that the failure to enact such a legislation will not be used in determining whether a state has diligently enforced its Qualifying Statute pursuant to the terms of the MSA, and that the diligent enforcement obligations under the MSA shall not apply to the Complementary Legislation. In addition, the written assurances contain an agreement that the Complementary Legislation shall not constitute an amendment to a Settling State's Qualifying Statute. However, a determination that a state's Complementary Legislation is invalid may make enforcement of its Qualifying Statute more difficult, which could lead to an increase in the market share of NPMs, resulting in a reduction of Annual Payments under the MSA. The State's Complementary Legislation has been challenged in a federal district court in New York by certain NPMs on constitutional grounds (including allegations that the Complementary Legislation is preempted by federal antitrust laws). See "Litigation Challenging the MSA, Qualifying Statutes and Related Legislation -*Freedom Holdings*, *Grand River* and Related Cases." See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Related to Model/Qualifying Statutes" and Appendix F-"DEFINITIONS AND SUMMARY OF THE INDENTURE – Non-Impairment Covenant" herein.

Should a PM be entitled to an NPM Adjustment in future years due to non-diligent enforcement of the Qualifying Statute by the State, the NPM Adjustment could have a material adverse effect on the payments by PMs under the MSA and the amounts of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds. See "Disputed or Recalculated Payments" below. The structuring assumptions for the Bonds do not include any NPM Adjustments. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Disputed or Recalculated Payments. Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "NPM Adjustment", have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. By way of example, on August 30, 2004, one of the SPMs announced that it had notified the attorneys general of 46 states that it intends to initiate proceedings against the attorneys general for violating the terms of the MSA. It alleges that the attorneys general violated its rights and the MSA by extending unauthorized favorable financial terms to Miami-based Vibo Corporation d/b/a General Tobacco when, on August 19, 2004, the attorneys general entered into an agreement with General Tobacco allowing it to become an SPM. General Tobacco imports discount cigarettes manufactured in Colombia, South America. In the notice sent to the attorneys general, the SPM indicated that it will seek to enforce the terms of the MSA, void the General Tobacco Agreement and enjoin the Settling States and NAAG from listing General Tobacco as a PM on their websites. On August 18, 2005, the SPM that sent the notice and an additional four SPMs filed a motion to enforce the MSA in Kentucky. The Commonwealth of Kentucky filed its opposition and the SPMs replied. General Tobacco intervened in the case and filed its opposition to the other SPMs' motion. The SPMs replied and a hearing was held on the issue on November 8, 2005. It was reported on January 31, 2006 that the court upheld the agreement by which General Tobacco became an SPM.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments. Both the diversion of disputed payments to the Disputed Payments Account and the application of offsets against future payments could have a material adverse effect on the payments by the PMs under the MSA and amounts of Pledged TSRs available to TSASC to make Turbo Redemptions and pay principal of and interest on the Series 2006-1 Bonds. The structuring assumptions for the Series 2006-1 Bonds do not factor in an offset for miscalculated or disputed payments. See “SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – Offset for Miscalculated or Disputed Payments” herein.

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

Bekenton is involved in a similar dispute in Iowa. In that case, the State of Iowa sought to de-list Bekenton as a PM for failing to comply with the MSA payment provisions and to prohibit Bekenton from doing business in Iowa for failing to comply with the escrow payment provisions of the Iowa Qualifying Statute. On August 11, 2005 an Iowa state court, finding that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case, enjoined Iowa from “de-listing” Bekenton, permitting Bekenton to continue selling cigarettes in Iowa.

In 2005, Bekenton filed for bankruptcy relief.

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

Other Risks Relative 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 nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA will terminate in all Settling States affected by the court's ruling. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Severability."

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

Reliance on State Enforcement of the MSA and State Impairment. The State may not convey and has not conveyed to the City, TSASC or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled under the Decree to 51.176% 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. It is possible that the State could attempt to claim some or all of the Pledged TSRs for itself or otherwise interfere with the security for the Bonds. In that event, the Bondholders, the Indenture Trustee, TSASC or the City may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be make as to the disposition of such claims. See "LEGAL CONSIDERATIONS."

Bankruptcy of PMs May Delay, Reduce or Eliminate Payments

The only significant source of payment for the Series 2006-1 Bonds (other than amounts in the Liquidity Reserve Account and interest earnings) is the Pledged TSRs that are paid by the PMs. Therefore, if one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of payments on the Series 2006-1 Bonds, and Bondholders could incur losses on their investments. Philip Morris, by way of example, prior to the resolution of the dispute in the *Price* case in Illinois in the spring of 2003 over the size of the required appeal bond, had publicly stated that it would not have been possible for it to post the $12 billion bond initially ordered by the trial judge. Philip Morris also publicly stated at that time that there was a risk that immediate enforcement of the judgment would force a bankruptcy. In addition, on May 13, 2003, Alliance Tobacco Corporation, one of the SPMs, filed for bankruptcy in the Western District of Kentucky and, in September 2004, its plan of reorganization was confirmed. As part of the confirmed plan, Alliance Tobacco Corporation effectively ceased its operations in September 2004. Bekenton also filed for bankruptcy relief in 2005.

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, the Bondholders, or the beneficial owners of the Bonds to collect any Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying Pledged TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Pledged TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Furthermore, payments previously made to the Bondholders and the beneficial owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the City, TSASC, the Indenture Trustee, the Bondholders, or the beneficial owners of the Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions or elimination of payments on the Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS" herein.

Recharacterization of the Transfer of TSRs as a Secured Borrowing Would Invalidate Sale of TSRs; Bankruptcy of the City; Substantive Consolidation of the City and TSASC May Result in Losses

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 a grant of a security interest in the Tobacco Assets, then delays in payments on the Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Bonds could result.. Losses suffered by Bondholders and beneficial owners of the Bonds 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 Bonds, the Bondholders and the beneficial owners of the Bonds could suffer a loss of their entire investment in such circumstances.

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 TSASC be substantively consolidated with those of the City. If a party in interest (including the City itself) were to take the position that the assets and liabilities of TSASC should be substantively consolidated with those of the City, delays in payments on the Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Bonds could result. 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 restriction may not be enforceable.

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

Regardless of any specific adverse determinations in a City bankruptcy proceeding, the fact of a City bankruptcy proceeding could have an adverse effect on the liquidity and value of the 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" herein.

Uncertainty as to Timing of Turbo Redemptions

No assurance can be given as to the timing of amortization of the Series 2006-1 Bonds. A certain level of payments due under the MSA has been forecast based on various assumptions, including among others, domestic cigarette consumption levels as set forth in the Global Insight Base Case Consumption Forecast and adjustments to the payments by the PMs as required by the terms of the MSA and the Consent Decree. These assumptions, which were used to schedule interest on, and Sinking Fund Installments and Turbo Term Bond Maturities of, the Series 2006-1 Bonds, as well as provide expectations of Turbo Redemptions of the Series 2006-1 Bonds from Surplus Collections are discussed in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION." 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 and could affect the level of payments due under the MSA. Any material reduction in Pledged TSRs or earnings on the Pledged Accounts would impair the Surplus Collections available to make Turbo Redemptions of the Series 2006-1 Bonds and extend the average life of the Series 2006-1 Bonds. On the other hand, material increases would generate more Surplus Collections to make Turbo Redemptions and shorten the average life of the Series 2006-1 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 2006-1 Bonds.

The ratings of the Series 2006-1 Bonds only address the payment of interest on the Series 2006-1 Bonds when due and the payment of principal of the Series 2006-1 Bonds on their respective Maturity Dates. Owners of the Series 2006-1 Bonds bear the reinvestment risk from faster than expected amortization, as well as the extension risk from slower than expected amortization of the Series 2006-1 Bonds.

Limited Resources of TSASC

The Bonds 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 Bonds. The Bonds are not obligations of the City or the State, and no recourse may be had to either for payment of amounts owing on the Bonds. Investors in the Series 2006-1 Bonds must look solely to the Collateral for repayment of their investment. TSASC's only source of funds for payments on the Bonds is the Collateral.

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.

Limited Liquidity of the Series 2006-1 Bonds; Price Volatility

The Underwriters are under no obligation to make a secondary market for the Series 2006-1 Bonds. There can be no assurance that a secondary market for the Series 2006-1 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 2006-1 Bonds. Tobacco settlement securitization bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2006-1 Bonds must be prepared to hold such securities for an indefinite period of time or until final redemption of such securities.

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

Any rating assigned to the Series 2006-1 Bonds by a Rating Agency will reflect such Rating Agency's assessment of the likelihood of the payment of interest when due on the Series 2006-1 Bonds and the payment of principal of Series 2006-1 Bonds by their respective Maturity Dates. Any such rating will not address the likelihood that the Turbo Redemptions will be made according to the Projected Turbo Redemption schedule or the likelihood of payment of the Sinking Fund Installments when due. The rating of the Series 2006-1 Bonds will not be a recommendation to purchase, hold or sell such Bonds and such rating will not address the marketability of such Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if, in such Rating Agency's judgment, circumstances so warrant based on factors prevailing at the time, including, but not limited to, the evaluation by such Rating Agency of the financial outlook for the tobacco industry. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, the Series 2006-1 Bonds.

S&P currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the Series 2006-1 Bonds, have a Negative Outlook. Fitch's view of the tobacco industry is a key factor in its ratings of tobacco settlement securitizations. Currently, Fitch indicates its outlook on the unsecured credit profile of the tobacco industry is negative.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2006-1 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 of Transaction Counsel are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM May Delay or Reduce Payments

Because the only significant source of payment for the Series 2006-1 Bonds (other than amounts in the Liquidity Reserve Account and interest earnings) is the Pledged TSRs paid by the PMs, if one or more PMs were to become a debtor in a case under the Bankruptcy Code, there could be delays or reductions in or elimination of payments on the Series 2006-1 Bonds. See "RISK FACTORS – Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of TSRs" herein.

In the bankruptcy of a PM, the automatic stay provisions of the Bankruptcy Code could prevent (unless approval of the bankruptcy court was obtained) any action by the State, the City, TSASC, the Indenture Trustee, the Bondholders, or the beneficial owners of the Bonds to collect any Pledged TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying Pledged TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Pledged TSRs. Transaction Counsel will render an opinion to the Rating Agencies that, subject to all the assumptions, qualifications, and limitations set forth therein, if a PM were to become the debtor in a case under the Bankruptcy Code, and the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that the MSA is an "executory contract" under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and 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 laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not an executory contract, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006-1 Bonds.

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

Furthermore, payments previously made to the Bondholders and the beneficial owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the City, TSASC, the Indenture Trustee, the Bondholders or the beneficial owners of the Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in, or elimination of, payments on the Series 2006-1 Bonds.

Recharacterization of the Transfer of TSRs as a Secured Borrowing Would Invalidate Sale of TSRs; Bankruptcy of the City; Substantive Consolidation of the City and TSASC May Result in Losses

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, delays in payments on the Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Bonds could result. Losses suffered by Bondholders and the beneficial owners of Bonds 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 Bonds, the Bondholders and the beneficial owners of the Bonds could suffer a loss of their entire investment in such circumstances.

Transaction Counsel will render an opinion to the Rating Agencies 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, 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 the 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 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 by the City to TSASC of the right to be paid the Tobacco Assets should be recharacterized as the grant of a security interest by the City in the right to be paid the Tobacco Assets, thus resulting in delays or reductions in, or elimination of, payments on the Bonds.

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 TSASC be substantively consolidated with those of the City. TSASC is a separate, special purpose nonprofit public benefit 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 restriction may not be enforceable.

Transaction Counsel will render an opinion to the Rating Agencies 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, 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 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 or reductions in, or elimination of, payments on the Bonds.

Actions could be taken in a bankruptcy of the City which would adversely affect the exclusion of interest on the 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 or reductions in, or elimination of, payments on the Bonds.

Regardless of any specific adverse determinations in a City bankruptcy proceeding, the fact of a City bankruptcy proceeding could have an adverse effect on the liquidity and value of the Bonds.

MSA Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA and could reduce the amount available to pay the principal of and interest on the Series 2006-1 Bonds.

Certain cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes and smokers' rights organizations have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA violates provisions of the United States Constitution, federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws and unfair competition laws, which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA or a determination that the MSA is void or unenforceable. To date, such challenges have not been ultimately successful, although two cases have survived pre-trial motions and have proceeded to a stage of litigation where the ultimate outcome may be determined in part by findings of fact based on extrinsic evidence as to the operation and impact of the MSA and appeals are pending or still possible in certain other cases. The terms of the MSA are currently being challenged and may continue to be challenged in the future. A determination by a court that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term as described above, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Transaction Counsel considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the MSA would advance in an attempt to invalidate the MSA. Subject to the assumptions and qualifications set forth below, Transaction Counsel will render an opinion to TSASC that, subject to all the assumptions, qualifications and limitations set forth therein, and although there can be no assurances that a court applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the MSA to be a valid and enforceable agreement among the states and the tobacco companies who are parties thereto.

Qualifying Statute Constitutionality

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

In rendering the opinions described below, Transaction Counsel considered the claims asserted in the federal and state actions described above under the caption "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the Qualifying Statute would advance in an attempt to invalidate the Qualifying Statute. Subject to the assumptions and qualifications set forth below, Transaction Counsel will render an opinion to TSASC that, subject to all the facts, assumptions and qualifications set forth therein, and although there can be no assurance that a court applying existing legal principles would not hold otherwise, if the matter were properly briefed and presented to a court, the court applying existing legal principles to the facts would find the State's Qualifying Statute to be constitutional and that the court applying existing legal principles to the facts would also find the State's Qualifying Statute to be enforceable and not violative of the antitrust laws. In rendering its opinion, Transaction Counsel will rely upon a letter dated January 19, 2000, from counsel to the OPMs confirming that the OPMs would not dispute that the State's Qualifying Statute constitutes a "model statute" under the MSA.

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

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

Impairment of Contracts

Although the MSA Escrow Agent has been instructed to pay the Pledged TSRs to the Indenture Trustee, 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 2006-1 Bonds. In that event the Bondholders could assert constitutional claims, including claims under the State and federal Due Process Clauses and the federal Contracts Clause.

The MSA, the Consent Decree, the TSR Purchase Agreement and the Indenture create property rights in the Bondholders, of which, under the State Constitution and the United States Constitution, the Bondholders cannot be deprived without due process of law, that is, a reasonable connection between the deprivation and the promotion of the public health, comfort, safety and welfare.

The Bondholders are further entitled to the benefit of the prohibition in the United States Constitution's Contracts Clause against any state's impairment of the obligation of contracts. This prohibition, although not absolute, is particularly strong when applied to a state's attempt to evade its own obligations. Although the State has not contracted directly with the Bondholders, it has entered into the Consent Decree allocating its share of the benefits of the MSA among itself, its counties and the City. The Pledged TSRs and money derived therefrom are the most significant source of payment for the Series 2006-1 Bonds.

In the absence of a great public calamity, it is unlikely that the State could alter the MSA, the Consent Decree or the financing arrangements in a manner that would substantially impair the rights of the Bondholders to be paid from the Pledged TSRs. No assurance can be given, however, that the State will not take action adverse to the Bondholders. The outcome of any such action cannot be predicted with certainty and, accordingly, Bondholders could incur a loss on their investment.

No Assurance as to the Outcome of Litigation

With respect to all matters of litigation that have been brought and may in the future be brought against the PMs, or involving the enforceability of the MSA or constitutionality of the State Qualifying Statute or the enforcement of the right to the Pledged TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) on the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amounts available to TSASC to pay the principal of and the interest on the Series 2006-1 Bonds.

THE SERIES 2006-1 BONDS

The following summary describes certain terms of the Series 2006-1 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 2006-1 Bonds. Copies of the Indenture may be obtained upon written request to the Indenture Trustee.

The Series 2006-1 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 2006-1 Bonds. The Series 2006-1 Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof in book-entry form only. Except under the limited circumstances described herein, no Beneficial Owner (as defined herein) of the Series 2006-1 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Bonds. See APPENDIX G—"BOOK-ENTRY ONLY SYSTEM" herein.

For each Distribution Date, payments will be made to registered owners of the Series 2006-1 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 2006-1 Bonds will be payable on each June 1 and December 1, commencing June 1, 2006. Each such interest payment date occurring on and after June 1, 2006, is a "**Distribution Date**." Interest will accrue from and including the Closing Date. Interest on the Series 2006-1 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Liquidity Reserve Account is available to pay interest on Bonds when due. Failure to pay the full amount of interest payable on any Distribution Date is an Event of Default.

If on any Distribution Date there are insufficient funds to pay all interest then due on the Bonds and Swap Payments, available amounts will be allocated Pro Rata among all Bonds and Swap Payments then due based on the respective amounts due thereon.

Payments of Principal

Principal on the Series 2006-1 Bonds will be payable on the respective Maturity Dates as set forth on the inside front cover of this Offering Circular, subject to special mandatory and optional redemption as provided in "Sinking Fund Installments," "Turbo Redemptions" and "Optional Redemption" below. So long as no Event of Default has occurred, all payments of principal made on the Bonds from Collections will be credited against Sinking Fund Installments and Turbo Term Bond Maturities in chronological order, as more fully described under "Effect of Redemptions on Sinking Fund Installments and Turbo Term Bond Maturities" below. The Liquidity Reserve Account is available to pay the principal of Bonds on their respective Maturity Dates. Failure to pay the principal of a Bond on its Maturity Date will constitute an Event of Default under the Indenture, in which case all future payments will be made on a Pro-Rata basis.

If less than all of the Series 2006-1 Bonds of any maturity are to be redeemed, the Owners of the Series 2006-1 Bonds of such maturity will be paid as described under the heading "Partial Redemptions" below.

Sinking Fund Installments

The Series 2006-1 Bonds maturing June 1, in the years 2022, 2026, 2034 and 2042 are subject to mandatory redemption from Sinking Fund Installments to the extent of available Collections in the amounts and on the dates set forth below, at a redemption price of par plus accrued interest to the date fixed for redemption. The Indenture provides that the Indenture Trustee shall not pay a Sinking Fund Installment unless, after giving effect to such payment, the Debt Service Account will contain sufficient funds to pay interest due on the next succeeding Distribution Date. Failure by TSASC to pay a Sinking Fund Installment when due is not an Event of Default under the Indenture. Amounts available in the Liquidity Reserve Account will not be available to pay Sinking Fund Installments.

Sinking Fund Installments for
Series 2006-1 Bonds Maturing June 1, 2022

June 1	Principal Amount	June 1	Principal Amount
2006	$8,685,000	2015	$15,295,000
2007	2,755,000	2016	16,965,000
2008	5,085,000	2017	18,715,000
2009	10,680,000	2018	25,130,000
2010	12,035,000	2019	26,295,000
2011	13,555,000	2020	27,440,000
2012	13,060,000	2021	28,965,000
2013	13,305,000	2022	30,345,000
2014	15,760,000		

Sinking Fund Installments for
Series 2006-1 Bonds Maturing June 1, 2026

June 1	Principal Amount	June 1	Principal Amount
2023	$31,880,000	2025	$35,290,000
2024	33,510,000	2026	37,085,000

Sinking Fund Installments for
Series 2006-1 Bonds Maturing June 1, 2034

June 1	Principal Amount	June 1	Principal Amount
2027	$38,935,000	2031	$47,540,000
2028	40,960,000	2032	49,580,000
2029	43,110,000	2033	52,300,000
2030	45,320,000	2034	54,905,000

Sinking Fund Installments for
Series 2006-1 Bonds Maturing June 1, 2042

June 1	Principal Amount	June 1	Principal Amount
2035	$57,960,000	2039	$70,995,000
2036	61,055,000	2040	75,160,000
2037	64,170,000	2041	79,035,000
2038	67,475,000	2042	83,175,000

Turbo Redemptions

The Series 2006-1 Bonds shall be subject to special mandatory Turbo Redemption, in whole or in part, at a redemption price of 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption, on each Distribution Date from Surplus Collections after payment of Operating Expenses, interest on the Bonds, Swap Payments, Sinking Fund Installments, Turbo Term Bond Maturities and replenishment of the Liquidity Reserve Account and Operating Contingency Account, if necessary. Moneys available for each such Turbo Redemption will be applied to redeem the Series 2006-1 Bonds as set forth under "Payments of Principal" above. Turbo Redemptions are not scheduled amortization payments and are to be made only from Surplus Collections, if any. Turbo Redemptions may also be made from amounts on deposit in the Partial Lump Sum Payment Account with confirmation from each Rating Agency that no rating then in effect with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended. Failure to pay Turbo Redemptions on Turbo Term Bonds will not constitute an Event of Default under the Indenture to the extent that such failure results from the insufficiency of Collections. Amounts in the Liquidity Reserve Account will not be used to make Turbo Redemptions.

Projected Turbo Redemptions for Series 2006-1 Bonds*

Turbo Redemption Date (June 1)	Series 2006-1 Bond Maturing June 1, 2022*	Series 2006-1 Bond Maturing June 1, 2026*	Series 2006-1 Bond Maturing June 1, 2034*	Series 2006-1 Bond Maturing June 1, 2042*	Cumulative Total**
2006	$29,465,000				$29,465,000
2007	21,500,000				50,965,000
2008	25,390,000				76,355,000
2009	27,760,000				104,115,000
2010	30,095,000				134,210,000
2011	32,650,000				166,860,000
2012	35,330,000				202,190,000
2013	38,070,000				240,260,000
2014	40,905,000				281,165,000
2015	2,905,000	$40,995,000			325,065,000
2016		47,290,000			372,355,000
2017		49,480,000	$1,375,000		423,210,000
2018			66,540,000		489,750,000
2019			71,180,000		560,930,000
2020			76,010,000		636,940,000
2021			81,225,000		718,165,000
2022			76,320,000	$10,365,000	804,850,000
2023				92,550,000	897,400,000
2024				98,765,000	996,165,000
2025				81,560,000	1,077,725,000
2026				49,200,000	1,126,925,000
2027				52,525,000	1,179,450,000
2028				56,035,000	1,235,485,000
2029				59,745,000	1,295,230,000
2030				13,235,000	1,308,465,000
2031				14,065,000	1,322,530,000
2032				14,925,000	1,337,455,000
2033				16,055,000	1,353,510,000

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

** Represents the full amount of principal projected to be paid on the Series 2006-1 Bonds from their date of issuance through and including the referenced date.

Limitations on Open Market Purchases

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

Optional Redemption

The Series 2006-1 Bonds are subject to optional redemption (from any source other than Collections) 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 at any time, but only in an amount that may not exceed the amount of the Projected Turbo Redemptions that were projected to be paid but, as of the date of such redemption, have not been paid with respect to such Series 2006-1 Bonds, and (2) in whole or in part on any date on or after June 1, 2016, 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.

Redemption of Defeased Bonds

In the event of a full or partial defeasance of the Series 2006-1 Bonds, the defeasance escrow will be structured to redeem the Series 2006-1 Bonds in accordance with the Projected Turbo Redemption schedule until any optional redemption of the Series 2006-1 Bonds.

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

All redemptions made under the Indenture from Collections will be credited as follows:

(1) the amount of any Turbo Redemptions will be credited against both Sinking Fund Installments and the Turbo Term Bond Maturities in chronological order; and

(2) the amount of any Sinking Fund Installments made will be credited against Turbo Term Bond Maturities in chronological order; provided, however, that Sinking Fund Installments scheduled for the same date will be credited Pro-Rata regardless of the maturity date of the related Term Bond Maturity.

Partial Redemptions

If less than all of the Series 2006-1 Bonds of a maturity are to be redeemed, the Series 2006-1 Bonds within such maturity 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 2006-1 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 2006-1 Bonds, DTC's practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

Mandatory Clean-up Call

The 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 exceed the aggregate principal amount of, and accrued interest on, all Outstanding Bonds and payments due under Swap Contracts.

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 money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest thereon will cease to accrue. The Indenture Trustee will give at least 15 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of 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.

Additional Parity Bonds

Additional Bonds may be issued under the Indenture to refund all Bonds in whole. Additional Bonds may also be issued under the Indenture to refund Bonds in part or for any other purpose but only if upon the issuance thereof: (A) the amount on deposit in the Liquidity Reserve Account following the issuance of the additional Bonds will be at least equal to the Liquidity Reserve Requirement; (B) no Event of Default shall have occurred; (C) the expected weighted average life of each Bond that will remain Outstanding after the date of issuance of the additional Bonds as computed 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 Bond as computed on the basis of new projections assuming that no such additional Bonds are issued plus (y) one year; (D) Rating Confirmation is received for any Bonds which are then rated by a Rating Agency that will remain Outstanding after the date of issuance of the additional Bonds; and (E) the definition of Pledged TSRs is amended to take into account the revised calculations pursuant to clause (C) above. Additional Bonds issued under this paragraph are referred to herein as "**Additional Parity Bonds**".

Subordinate Bonds

Subordinate bonds may be issued for any other additional purpose by TSASC if there is no payment permitted for such bonds until all then outstanding Bonds are Fully Paid. Subordinate bonds may be issued without satisfying the requirements of the Indenture relating to Additional Parity Bonds.

APPLICATION OF BOND PROCEEDS

The proceeds of the Series 2006-1 Bonds shall be applied as follows:

Refunding of Refunded Bonds	$1,218,454,149
Deposit to Liquidity Reserve Account	85,399,238
Payment of costs of issuance[(1)]	11,136,793
Original Issue Discount	38,519,820
Total	$1,353,510,000

(1) Costs of issuance include underwriters' discount, legal fees, rating agency fees, econometric consultant fees, verification agent fees, printing costs and certain other expenses related to the issuance of the Series 2006-1 Bonds.

SECURITY FOR THE BONDS

Pledge of Collateral

Pursuant to the Indenture, the Bonds and the Swap Payments 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 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 Operating Account, the Operating Contingency Account or the Rebate Account) and all investment earnings on amounts on deposit in or credited to the Pledged Accounts; (c) any payment received by TSASC pursuant to a Swap Contract; and (d) all present and future claims, demands, causes, and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments, payment intangibles, and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing. 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 as provided herein.

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 and any party that has entered into a Swap Contract.

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

Applicable Percentage of Pledged TSRs

The TSRs pledged under the Indenture (the "**Pledged TSRs**") represent, as of any date, the right, title and interest of TSASC in and to the Applicable Percentage of the Tobacco Assets as of such date. The "**Applicable Percentage**" means 37.40%; provided, however, that on June 1, 2024 and on each June 1 thereafter if Cumulative Actual Turbo Redemptions equal or exceed the Cumulative Projected Turbo

Redemptions, the Applicable Percentage will mean the percentage shown on the following table opposite such June 1 and shall become effective on the next day.

Applicable Percentage of Pledged TSRs

	Cumulative Projected Turbo Redemptions	Applicable Percentage	Effective Date of Applicable Percentage
June 1, 2024	$996,165,000	30.10%	June 2, 2024
June 1, 2025	1,077,725,000	18.68	June 2, 2025
June 1, 2026	1,126,925,000	18.68	June 2, 2026
June 1, 2027	1,179,450,000	18.68	June 2, 2027
June 1, 2028	1,235,485,000	18.68	June 2, 2028
June 1, 2029	1,295,230,000	4.25	June 2, 2029
June 1, 2030	1,308,465,000	4.25	June 2, 2030
June 1, 2031	1,322,530,000	4.25	June 2, 2031
June 1, 2032	1,337,455,000	4.25	June 2, 2032 and thereafter

Upon the issuance of Additional Parity Bonds the definition of Pledged TSRs will be amended to take into account the issuance of such Bonds.

"**Cumulative Actual Turbo Redemptions**" means, as of June 1, 2024, and each June 1 thereafter, the principal amount of all actual redemptions from the date of issuance of the Series 2006 1 Bonds through and including such June 1.

"**Cumulative Projected Turbo Redemptions**" means, as of June 1, 2024, and each June 1 thereafter, the amount shown on the preceding table under "Cumulative Projected Turbo Redemptions" opposite such June 1.

Application of Collections

The Indenture Trustee will deposit all Collections, excluding investment earnings on amounts on deposit with the Indenture Trustee under the Indenture, in the Collections Account promptly upon receipt. All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Indenture Trustee will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Indenture Trustee will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied in the manner described under "Distribution Date Transfers" below. Not later than May 15 of each year commencing May 15, 2006, the Indenture Trustee will transfer to the Collections Account and apply as set forth under "Transfers to Accounts" below all Collections consisting of investment earnings on amounts on deposit with the Indenture Trustee in the Pledged Accounts (excluding amounts in the Partial Lump Sum Payment Account), except that all amounts in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement shall be transferred to the Debt Service Account, unless such excess occurs as the result of a deposit of a surety, guaranty or similar agreement in the Liquidity Reserve Account in lieu of cash, in which case any surplus will be transferred to the Unpledged TSRs Account.

Transfers to Accounts. As soon as practicable, but no later than the earlier of (a) the fifth Business Day following each Deposit Date, or (b) the Distribution Date following each Deposit Date, the

Indenture Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts as follows:

(i) to the Operating Account, an amount sufficient to cause the amount therein to equal the amount specified by an Officer's Certificate delivered with respect to the 12-month period applicable to such Officer's Certificate, in order to pay, (a) the Operating Expenses (excluding any Termination Payments), to the extent that the amount thereof does not exceed the Operating Cap, and (b) the Tax Obligations;

(ii) to the Debt Service Account an amount sufficient to cause the amount therein (taking into account any amounts on deposit in the Capitalized Interest Subaccount) to equal the sum of (a) interest on the Outstanding Bonds and all Swap Payments that will come due (1) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (2) in the then-current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (b) any such unpaid interest on the Bonds and all Swap Payments from prior Distribution Dates (including interest at the stated rate on such unpaid interest, to the extent legally permissible); provided that the amount to be deposited pursuant to this clause (ii) shall be calculated assuming that principal of the Bonds will have been paid as described in clauses (ii), (iii), (iv) and (v) under "Distribution Date Transfers" below;

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

(iv) unless an Event of Default has occurred, to the Liquidity Reserve Account an amount sufficient to cause the amount on deposit therein to equal the Liquidity Reserve Requirement;

(v) to the Operating Contingency Account, the amount, if any, necessary to make the amount therein equal to the amount specified by the Officer's Certificate most recently delivered or deemed delivered in order to pay, for the 12-month period applicable to such Officer's Certificate, the Operating Expenses in excess of the Operating Cap or Termination Payments; and

(vi) to the Turbo Redemption Account all amounts remaining in the Collections Account.

Distribution Date Transfers. Unless an Event of Default has occurred, on each Distribution Date, the Indenture Trustee will apply amounts in the various funds and accounts in the following order of priority:

(i) from the Capitalized Interest Subaccount of the Debt Service Account, the Debt Service Account, the Partial Lump Sum Payment Account and the Liquidity Reserve Account, in that order, to pay interest on the Bonds and all Swap Payments due on such Distribution Date;

(ii) from the Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay in the following order, the Serial Maturity, if any, the Sinking Fund Installment and Term Bond Maturities (including Turbo Term Bond Maturities), if any, due on or scheduled for such Distribution Date, plus any Serial Maturities, if any, Sinking Fund Installments and Term Bond Maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, but the amount of each

Sinking Fund Installment will first be adjusted to account for prior principal payments, and the Indenture Trustee will not pay a Sinking Fund Installment pursuant to the provisions described in this clause (ii) unless the Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date;

(iii) from the Liquidity Reserve Account first to pay the Serial Maturities, if any, and Turbo Term Bond Maturities due on or scheduled for such Distribution Date, plus any Serial Maturities, if any, and Turbo Term Bond Maturities unpaid from prior Distribution Dates and then to reimburse the provider of a surety, guaranty or other similar agreement for any payment thereunder or draw thereon for a purpose for which the Liquidity Reserve Account is otherwise available;

(iv) from the Turbo Redemption Account, to redeem Turbo Term Bonds on such Distribution Date in chronological order of Sinking Fund Installment payment dates and Turbo Term Bond Maturity Dates; and

(v) from the Partial Lump Sum Payment Account to redeem the Series 2006-1 Bonds on such Distribution Date in chronological order of Sinking Fund Installment payment dates and Turbo Term Bond Maturity Dates, but only as directed in an Officer's Certificate delivered by TSASC and accompanied by confirmation from each Rating Agency that no rating then in effect with respect to the Bonds from such Rating Agency will be withdrawn, reduced or suspended.

Upon the occurrence of any Event of Default, and continuing on each succeeding Distribution Date commencing with the Distribution Date following the Event of Default, the Indenture Trustee will apply all funds in the Debt Service Account, the Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Bonds and all Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, second, principal of all Bonds then Outstanding.

Upon the receipt of a Total Lump Sum Payment, the Indenture Trustee will, after making provision for the amounts required to be deposited pursuant to clause (i) under "Transfers to Accounts" above, use all remaining proceeds of such Total Lump Sum Payment to pay Pro Rata, first, the accrued interest on the Bonds and all Swap Payments (including interest at the stated rate on any unpaid interest, to the extent legally permissible) and, second, principal of all Bonds then Outstanding.

Tobacco Settlement Revenues; City Covenant

The City has provided through the TSR Purchase Agreement for TSASC's ownership and receipt of the TSRs. Under the Indenture, TSASC acknowledges that the MSA, the Decree and the TSR Purchase Agreement constitute important security provisions of the Bonds and waives any right to indirectly assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the City, the State or any other person of, any such claim to the contrary.

By acknowledging that the MSA, the Decree and the TSR Purchase Agreement constitute important security provisions of the Bonds, TSASC also acknowledges under the Indenture that, in the event of any failure or refusal by the City or the State to comply with their agreements included in the MSA, the Decree and the TSR Purchase Agreement, the Bondholders may have suffered monetary damages, the extent of the remedy for which may be, to the fullest extent permitted by applicable Federal and State law, determined, in addition to any other remedy available at law or in equity, in the course of any action taken pursuant to the Indenture; and TSASC waives any right to indirectly assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the City, the State or any other person of, any claim to the effect that no such monetary damages have been suffered.

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.

No Indebtedness or Funds of City

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.

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.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA which is attached hereto as Appendix C.

General

The MSA is an industry-wide settlement of litigation between the Settling States and the OPMs and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies (the "**SPMs**") to become parties to the MSA. The three OPMs together with the 44 SPMs are referred to as the "**PMs**." The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to the National Association of Attorneys General ("**NAAG**"), as of January 3, 2006, 47 PMs have signed the MSA. The chart below identifies each of the PMs which was a party to the MSA as of January 3, 2006:

OPMs	SPMs	
Lorillard Tobacco Company	Anderson Tobacco Company, LLC	Lignum-2, Inc.
Philip Morris, USA (formerly Philip Morris Incorporated)	Bekenton, S.A.	Mac Baren Tobacco Company A/S
Reynolds American, Inc. (formerly R.J. Reynolds Tobacco Company and Brown & Williamson Tobacco Corporation)	Canary Islands Cigar Co.	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
	Caribbean-American Tobacco Corp. (CATCORP)	NASCO Products, Inc.
	Chancellor Tobacco Company, PLC	P.T. Djarum
	Commonwealth Brands, Inc.	Pacific Stanford Manufacturing Corporation
	Cutting Edge Enterprises, Inc.	Peter Stokkebye Tobaksfabrik A/S
	Daughters & Ryan, Inc.	Planta Tabak-manufaktur Gmbh & Co.
	M/s. Dhanraj International	Poschl Tabak GmbH & Co. KG
	Eastern Company S.A.E.	Premier Manufacturing Incorporated
	Farmer's Tobacco Co. of Cynthiana, Inc.	Santa Fe Natural Tobacco Company, Inc.
	General Tobacco (Vibo Corporation d/b/a General Tobacco)	Sherman's 1400 Broadway N.Y.C. Inc.
	House of Prince A/S	Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	Imperial Tobacco Limited/ITL (USA) Limited	Tabacalera del Este, S.A. ("TABESA")
	International Tobacco Group (Las Vegas), Inc.	Top Tobacco, LP
	Japan Tobacco International USA, Inc.	U.S. Flue Cured Tobacco Growers, Inc.
	King Maker Marketing	Vector Tobacco Inc.
	Konci G&D Management Group (USA) Inc.	Virginia Carolina Corporation, Inc.
	Kretek International	Von Eicken Group
	Lane Limited	Wind River Tobacco Company, LLC
	Liberty Brands, LLC	VIP Tobacco USA, LTD. (formerly Winner Sales Company)
	Liggett Group, Inc.	ZNF International, LLC (no current brands)

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

Scope of Release

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

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

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

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

To the extent that the New York Attorney General does not have the power or authority to bind any of the New York Releasing Parties, the release of claims contemplated by the MSA may be ineffective as to the Releasing Parties and any amounts that become payable by the PMs on account of their claims, whether by way of settlement, stipulated judgment or litigated judgment, will trigger the Litigating Releasing Parties Offset. See "—Adjustments to Payments" below.

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

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments and Annual Payments.[*] See "—Initial Payments," and "—Annual Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustments to Payments" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and the PMs have made the Annual Payments for 2000, 2001, 2002, 2003, 2004 and 2005 (subject to certain withholdings described in "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA" herein). Pledged TSRs do not include any payments made before the date of delivery of the Series 2006-1 Bonds. See "—Payments Made to Date" below.

[*] Other payments that are required to be made by the PMs, such as strategic contribution fund payments, payments of attorneys' fees and payments to a national foundation established pursuant to the MSA, are not allocated to the City and are not available to TSASC, and consequently are not discussed here.

Payments required to be made by the OPMs are calculated by reference to the OPM's domestic shipments of cigarettes, with the amount of the payments adjusted annually roughly in proportion to the changes in total volume of cigarettes shipped by the OPMs in the United States in the preceding year. Payments to be made by the PMs are recalculated each year, based on the United States market share of each individual PM for the prior year, with consideration under certain circumstances, for the profitability of each OPM. The Annual Payments required to be made by the SPMs are based on increases in their shipment market share. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, remaining 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.

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

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.70 billion, was paid in December 2002 and January 2003, in the approximate aggregate amount of $2.14 billion after taking into account various adjustments.

Annual Payments

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

Annual Payments

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

* The 2000 through 2005 Annual Payments have been made. However, subsequent adjustments to these Annual Payments may impact subsequent Annual Payments.

The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The base annual payments in the above table will be increased by at least the minimum 3% Inflation Adjustment, adjusted by the Volume Adjustment, reduced by the Previously Settled States Reduction, and further adjusted by the other adjustments described below. The SPMs are required to make Annual Payments if their respective market share increases above the higher of their respective 1998 Market Share or 125% of their 1997 Market Share.

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

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

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

Application of these adjustments resulted in a material reduction of TSRs from the scheduled base amounts of the Annual Payments made by the PMs in April of the years 2000 through 2005, as discussed below under the heading "—Payments Made to Date."

Adjustments to Payments

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

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

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

Non-Settling States Reduction. In the event that the MSA terminates as to any Settling State, the remaining Annual Payments due from the PMs 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. If the aggregate market share of the PMs in any year falls more than 2% below the aggregate market share held by those same PMs in 1997, and if a nationally recognized economic firm determines 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, then an adjustment (the "**NPM Adjustment**") is applied to the subsequent year's Annual Payment due to those Settling States that have been proven to not diligently enforce their Model Statutes. The 1997 market share percentage for the PMs, less 2%, is defined as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs will 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 16⅔%, the NPM Adjustment will be calculated as follows:

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

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments due from the PMs. The NPM Adjustment applies only to the Annual 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 enforcing the Model Statute or a Qualifying Statute (as defined herein). Any Settling State that adopts and diligently enforces a Model Statute or Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment will not exceed 65% of the amount of such state's allocated payment. If, on the other hand, a Qualifying Statute which is not a Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts a Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See "RISK FACTORS—Other Potential Payment Decreases under the Terms of the MSA—NPM Adjustment" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes" above.

The MSA provides that if any Settling State resolves claims against any NPM that are comparable to any of the claims released in the MSA on overall terms more favorable to such NPM, the same terms will be extended to all PMs.

Offset for Miscalculated or Disputed Payments. If the MSA Auditor receives notice of a miscalculation of an Initial Payment made by an OPM or 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 is required to be paid into the Disputed Payments Account pending resolution of the dispute. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing.

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**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. Fourteen of the current 44 SPMs signed the MSA on or before the February 22, 1999 deadline.

For each Annual Payment, each SPM is required to pay an amount equal to the base amount of the Annual Payment owed by the OPMs, collectively, adjusted for the Volume Adjustment described above but prior to any other adjustments, reductions or offsets, multiplied by (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 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.

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first six Annual Payments and the MSA Escrow Agent has disbursed to TSASC its allocable portions thereof and certain other amounts under the MSA totaling $1,421,797,220 to date. These amounts are not pledged to payment of the Series 2006-1 Bonds. Under the MSA, the computation of Initial Payments and Annual Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to TSASC by the State.

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

	Base Payment Allocable to TSASC	**TSASC's Actual Receipts***
Up-Front Initial Payment	$81,687,208	$84,042,678
2000 Initial Payment	84,137,824	73,199,907
2000 Annual Payment	153,163,515	117,697,880
2001 Initial Payment	86,661,959	65,936,513
2001 Annual Payment	170,181,683	140,076,476
2002 Initial Payment	89,261,818	68,094,739
2002 Annual Payment	221,236,188	186,823,855
2003 Initial Payment	91,939,672	72,843,969
2003 Annual Payment	221,236,188	182,136,393
2004 Annual Payment	272,290,693	213,962,662
2005 Annual Payment	272,290,693	216,982,148

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

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

The State has advised TSASC that both the Settling States and one or more of the PMs are disputing the calculations of the Initial Payments for 2000 through 2003 and the Annual Payments for 2000 through 2005. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the NPM than the MSA does to the PMs, the terms of the MSA will be deemed modified to match the NPM settlement, but only with respect to the particular Settling State. In the event that any Settling State agrees to reduce the burden placed upon any PM by the terms of the MSA, the MSA will be deemed modified so that each PM enjoys the same reduction in burden, 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.

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

Disbursement of Funds from Escrow

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

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

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not: (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of proofs-of-purchase coupons. The PMs are also prohibited from placing any new outdoor and transit advertising, and are committed to remove any existing outdoor and transit advertising for Tobacco Products in the Settling States. Other examples of prohibited activities include, subject to limited exceptions: (i) the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; (ii) the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; (iii) the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages; and (iv) the sale of packs of cigarettes containing fewer than 20 cigarettes until at least December 31, 2001.

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

Remedies upon the Failure of a PM to Make a Payment

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

Termination of Agreement

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

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

Severability

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

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

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

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

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

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

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

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

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

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

The amounts deposited in 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) 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 Participating Manufacturer 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 clause (i) or (ii)).

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

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

In October 2003, the State enacted an Allocable Share Release Amendment to amend Article 13-G by eliminating the provision authorizing an NPM to obtain the release of the amount by which its annual escrow deposit exceeds 12.7620310% of the total payments that the NPM would have made as a PM for that year. Under the State's Allocable Share Release Amendment, an NPM would have been entitled to the release of its escrow deposit only to the extent that it exceeded the total amount that the NPM would have paid as a PM. A majority of the PMs, including all three OPM's had indicated in writing that in the event a Settling State enacted legislation substantially in the form of the Allocable Share Release Amendment, the Settling State's previously enacted Qualifying Statute would continue to constitute a Model Statute and a Qualifying Statute within the meaning of the MSA.

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

Complementary Legislation. Pursuant to the State's Complementary Legislation, tobacco product manufacturers whose cigarettes are sold in the State are required to annually certify that either (i) they are

PMs that have complied with requirements of the MSA or (ii) they have complied with the Public Health Law requirement to deposit money in a qualified escrow fund. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the Complementary Legislation, and such cigarettes can be seized and are subject to forfeiture.

NEW YORK CONSENT DECREE

The following summary describes certain provisions of the Decree. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Decree, a copy of which is attached hereto as Appendix C.

Introduction and Overview

On December 23, 1998, the Consent Decree and Final Judgment (the "**Decree**"), which governs the class action portion of the State's action against the tobacco companies, was entered in the Supreme Court of the State of New York. The Decree provides for: (i) the allocation of the amounts in the New York state-specific account among the State, the counties of New York and the City; (ii) limitations on the rights of the counties and the City to enforce the provisions of the Decree; and (iii) the release and dismissal of claims by the counties and the City.

The Appellate Division affirmed the Decree in a unanimous decision dated July 15, 1999. The period in which to appeal the decision of the Appellate Division expired on August 16, 1999 without any request to appeal being served. The time for all appeals against the Decree has expired.

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 Initial Payments and Annual Payments to be made pursuant to the MSA to the State, its counties and the City is set forth in the Decree, which provides that the State and the City are to receive 51.176% and 26.670%, respectively, of the Initial Payments and the Annual Payments. TSASC has purchased all of the City's right, title and interest in and to such payments pursuant to the TSR Purchase Agreement. Under the Indenture, TSASC has assigned and pledged the Pledged TSRs to the Indenture Trustee to secure 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, do not pass through either the State or the City, and are not subject to State or City appropriation.

Rights to Enforce Provisions of the Consent Decree

In addition to allocating the Initial Payments and Annual Payments among the State, its counties and the City, 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 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, effective upon the occurrence of State-Specific Finality in the State, the counties and the City 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 counties and the City agree that, after the occurrence of State-Specific Finality, 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.

DOMESTIC TOBACCO INDUSTRY

*The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their parent companies and certain publicly available analyses of the tobacco industry and other public sources. Certain of the companies file annual, quarterly, and certain other reports with the Securities and Exchange Commission (the "**SEC**"). Such reports are available on the SEC's website (www.sec.gov). 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. 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 State's Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2006-1 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2006-1 Bonds is consistent with their investment objectives.*

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. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Overview of Payments by the Participating Manufacturers; MSA Escrow Agent "—Annual Payments" herein. Additionally, aggregate market share information, based upon shipments as reported by Loews Corporation and reflected in the chart herein entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that utilized in the bond structuring assumptions. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

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

Industry Overview

According to publicly available documents of Loews Corporation, the parent company of Lorillard, Inc., the three leading manufacturers of tobacco products in the United States in 2004 collectively accounted for approximately 85.0% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the United States divides generally into premium and discount sales, approximately 71.3% and 28.7%, respectively, measured by volume of all domestic cigarette sales as of the third quarter of 2005, as reported by Loews Corporation.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the United States. Prior to a name change on January 27, 2003, the Altria Group, Inc. was named Philip Morris Companies Inc. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004, Altria reported that Philip Morris' domestic retail market share in 2004 was 49.8% (based on sales), which represents an increase of 1.1 share points from its self-reported 2003 domestic retail market share (based on sales) of 48.7%. In its quarterly report on Form 10Q filed with the SEC for the three months ended September 30, 2005, Altria reported that Philip Morris' domestic retail market share for such quarter was 50.1 % (based on sales), which represents an increase of 0.2 share points from its reported domestic retail market share (based on sales) of 49.9 % for the comparable quarter of 2004. Altria released its calendar 2005 results of operation on January 31, 2006. In its release, Altria reported that Philip Morris' domestic retail market share for the year ended December 31, 2005 was 50.0% (based on sales), which represents an increase of 0.2 share points from its self-reported 2004 domestic retail market share of 49.8% (based on sales). Altria also reported that Philip Morris' domestic retail market share for the three months ended December 31, 2005 was 50.0% (based on sales), which represents an increase of 0.1 share points from its reported domestic retail market share of 49.9% (based on sales) for the comparable quarter of 2004. Philip Morris' major premium brands are Marlboro, Virginia Slims and Parliament. Its principal discount brand is Basic. Marlboro is the largest selling cigarette brand in the United States, with approximately 40.0% of the United States domestic retail share for calendar 2005, up from 39.5% for calendar 2004, and has been the world's largest-selling cigarette brand since 1972. Philip Morris' market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales.

Reynolds American Inc. ("**Reynolds American**"), is the second largest tobacco company in the United States. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corp. ("**B&W**"), previously the third largest tobacco company in the United States, under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004, Reynolds American reported that its domestic retail market share in 2004 was 30.8% (measured by sales volume), which represents a decrease of 1.3 share points from the 32.1% 2003 combined domestic retail market share of Reynolds Tobacco and B&W. In its quarterly report on Form 10Q filed with the SEC for the three months ended September 30, 2005, Reynolds American reported that its domestic retail market share for the quarter was 29.66% (measured by sales volume), which represents a decrease of 1.08 share points from its reported domestic retail market share of 30.75% (measured by sales volume) for the comparable quarter of 2004. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation, is the third largest tobacco company in the United States. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004, Loews

Corporation reported that Lorillard's domestic retail market share in 2004 was 8.8% (measured by shipment volume), which represents an increase of 0.2 share points from its self-reported 2003 domestic retail market share of 8.6%. In its quarterly report on Form 10-Q filed with the SEC for the three months ended September 30, 2005, Loews Corporation reported that Lorillard's domestic retail market share for the quarter was 9.2% (measured by shipment volume) which represents an increase of 0.5 share points from its reported domestic retail share (measured by shipment volume) of 8.7% for the comparable quarter of 2004. Lorillard's principal brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 91% of Lorillard's unit sales in 2004. Market share data reported by Lorillard is based on data made available by Management Science Associates, Inc. ("**MSAI**"), an independent third-party database management organization that collects wholesale shipment data.

Based on the domestic retail market shares discussed above, the remaining share of the United States retail cigarette market in 2004 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fourth largest tobacco company in the United States. In its Form 10-K filed with the SEC for the year ended December 31, 2004, Vector reported that Liggett's domestic retail market share in 2004 was 2.3% (measured by shipment volume and using MSAI data), which represents a decrease of 0.1 share points from its self-reported 2003 domestic retail market share of 2.4%. All of Liggett's unit volume in 2004 was in the discount segment. Its brands include Liggett Select, Eve, Jade, Pyramid and USA. In November 2001, Vector Group launched OMNI, which Vector Group claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. Additionally, Vector Group announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Liggett and Vector Group Ltd. are SPMs under the MSA.

Reynolds American has announced that it will release its calendar 2005 results of operation on February 8, 2006. Loews Corporation and Vector may similarly release their respective calendar 2005 results of operations after the sale of the Series 2006-1 Bonds but before the Closing Date. Calendar 2005 results of operation for the above PMs may reflect material adverse changes in their respective businesses or financial condition.

Shipment Trends

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

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

Despite the effects of MSAI's new estimation model for deep discount manufacturers, Lorillard management has indicated that it continues to believe that volume and market share information for the deep discount manufacturers are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

Manufacturers' Domestic Market Share Based on Shipments[1]

Manufacturer	2002	2003	2004
Philip Morris	45.7%	46.7%	47.4%
Reynolds American[2]	32.1	29.6	28.8
Lorillard	8.5	8.6	8.8
Other[3]	13.7	15.1	15.0

(1) Aggregate market share as reported by Loews Corporation is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of their filings with the SEC.
(2) Prior to July 2004, represents the combined market share of Reynolds Tobacco and B&W.
(3) The market share based on shipments of the tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in the publicly available documents of Loews Corporation from 100%.

The following table sets forth the industry's cigarette shipments in the United States for the three years ended December 31, 2004. The MSA payments are calculated in part on shipments by the OPMs in or to the United States rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)[1]
2002	418.4
2003	401.2
2004	394.5

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

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

Consumption Trends

According to April 2005 and September 2005 estimates of the United States Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the United States consumed an estimated 388 billion cigarettes in 2004, which would represent a decrease of approximately 2.5% from the previous year. The USDA-ERS attributes declining cigarette use to a combination of higher consumer costs due to tax and price increases, restrictions on where people can smoke and greater awareness of the health risks associated with smoking. Annual per capita consumption (per adult over 18) has dropped from 2,505 cigarettes in 1995 to an estimated 1,770 in 2004. The following chart sets forth domestic cigarette consumption from 2000 through 2004:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)[(1)]
2000	430
2001	425
2002	415
2003	400
2004	388

(1) USDA-ERS. The MSA Payments are calculated in part based on domestic industry shipments rather than consumption. The Global Insight Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Distribution, Competition and Raw Materials

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

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

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

Grey Market

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

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the U.S. Food and Drug Administration (the "**FDA**"), amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. Philip Morris has indicated its strong support for this legislation. No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes.

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

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

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

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

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

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

On May 21, 1999, the OPMs filed lawsuits in the United States District Court for the District of Massachusetts to enjoin implementation of certain Massachusetts attorney general regulations concerning the advertisement and display of tobacco products. The regulations went beyond those required by the MSA, and banned outdoor advertising of tobacco products within 1,000 feet of any school or playground, as well as any indoor tobacco advertising placed lower than five feet in stores within the 1,000-foot zone. The district court ruled against the industry on January 25, 2000, and the United States Court of Appeals for the First Circuit affirmed. The United States Supreme Court granted the industry's petition for writ of certiorari on January 8, 2001, and ruled in favor of RJR Tobacco and the rest of the industry on June 28, 2001. The Supreme Court found that the regulations were preempted by the Federal Cigarette Labeling and Advertising Act, which precludes states from imposing any requirement or prohibition based on smoking and health with respect to the advertising or promotion of cigarettes labeled in conformity with federal law.

In June 2000, the New York state legislature passed legislation charging New York's Office of Fire Prevention and Control ("**OFPC**") with developing standards for "fire-safe" or self-extinguishing cigarettes. On December 31, 2003, OFPC issued a final standard with accompanying regulations that requires all cigarettes offered for sale in the State after June 28, 2004 to achieve specified test results when placed on 10 layers of filter paper in controlled laboratory conditions. Reynolds American's operating companies that sell cigarettes in New York state have provided written certification to both the OFPC and the Office of the Attorney General for the State that each of their cigarette brand styles currently sold in the State has been tested and has met the performance standards set forth in the OFPC's regulations. Design and manufacturing changes were made for cigarettes manufactured for sale in New York to comply with the standard. In June 2005, Vermont became the second state to pass legislation requiring that all cigarettes sold within the state be self-extinguishing. Vermont's legislation goes into effect May 1, 2006. In October 2005, California enacted a similar law that will take effect on January 1, 2007. Similar legislation is being considered in a number of other states. Varying standards from state to state could have an adverse effect on the PMs.

According to the Global Insight Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in ten states and a few large cities. California imposed comprehensive statewide smoking bans in 1998 and banned smoking in its prisons effective July 1, 2005. Delaware banned smoking in all indoor public areas in 2002. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Also in 2003, Connecticut, Maine, and Florida passed laws which ban smoking in restaurants and bars. Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. Since then Massachusetts, Montana, Rhode Island, and Vermont have established similar bans. Voters in Washington State passed a ballot initiative in November 2005 which bans smoking in all public places effective January 2006. The restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. In January 2006, New Jersey adopted a comprehensive ban which will go into effect in April 2006. At the same time New Jersey increased the minimum legal age to purchase cigarettes from 18 to 19 years. Three states, Alabama, Alaska, and Utah, also set the minimum age at 19. In December 2005 Chicago passed a smoking ban which also applies within 15 feet of entrances. It went into effect in January 2006, with an exemption for bars until July 2008. Also in January the District of Columbia enacted an extensive ban which will be fully in effect in January 2007. It is expected that these restrictions will continue to proliferate. In 2006 at least five states, Arkansas, Colorado, Iowa, Maryland and Utah, are considering comprehensive bans. On January 26, 2006 the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant. The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of January 3, 2006, there were 2,129 municipalities in the U.S. with indoor smoking restrictions.

In addition, the Settling States' attorneys general were recently successful in obtaining agreement from Philip Morris, Reynolds American and B&W that they will remove product advertising from various magazines that are circulated in schools for educational purposes.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the United States, that had ratified the treaty prior to November 30, 2004. As of April 27, 2005, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. It has been reported that as of November 3, 2005, 100 countries had ratified the FCTC.

Excise Taxes. Cigarettes are also currently subject to substantial excise taxes in the United States. The federal excise tax per pack of 20 cigarettes is $0.39 as of November, 2005. All states, the District of Columbia and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.46 per pack in Rhode Island. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City. According to the Global Insight Consumption Report, excise tax increases were enacted in 20 states and New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states in 2005. The population-weighted average state excise tax as of December, 2005 was $0.913 per pack. In 2006 at least eight states are considering proposed excise tax increases, including a $1.00 increase outside the City in a budget proposal by the Governor of the State. In addition, the Mayor of the City has proposed a $0.50 increase in the City.

These tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes.

Civil Litigation

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from ETS, also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of September 30, 2005, there were 13 cases on appeal in which verdicts were returned against Philip Morris, including a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. The Supreme Court of Illinois heard the defendant's appeal in *Price* and dismissed the case. It has been reported that the plaintiffs have filed a motion asking the court to reconsider its decision. See "—Class Action Lawsuits" below. The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins (the *Broin II* cases, discussed below), (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) healthcare cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for healthcare expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act.

According to Altria, since January 1999 and through September 30, 2005, verdicts have been returned in 43 smoking and health cases, Lights/Ultra Lights cases and healthcare cost recovery cases in which Philip Morris was a defendant. Verdicts in favor of Philip Morris and other tobacco industry defendants were returned in 27 of these cases. Verdicts in favor of plaintiffs were returned in 16 cases. Appeals or post-trial motions by defendants and by plaintiffs are pending in many of these cases. Of the 16 cases in which verdicts were returned in favor of plaintiffs, three have reached final resolution with respect to Philip Morris. A $17.8 million verdict against defendants in a healthcare cost recovery case in New York was reversed, and all claims were dismissed with prejudice in February 2005 in the *Blue*

Cross/Blue Shield case. In October 2004, after exhausting all appeals, Philip Morris paid $3.3 million in an individual smoking and health case in Florida (the *Eastman* case, discussed below). In March 2005, after exhausting all appeals, Philip Morris paid $17 million in an individual smoking and health case in California (the *Henley* case, discussed below). In addition, in February 2005, after exhausting all appeals, Reynolds Tobacco, due to its obligation to indemnify B&W, paid approximately $9.1 million in the *Boerner* case (see below) and on June 17, 2005, after exhausting all appeals, Reynolds Tobacco paid a $196,416 plus interest and costs judgment in an individual case in Kansas (the *Burton* case, discussed below).

Class Action Lawsuits. The MSA does not release the PMs from liability in class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking, price fixing and consumer fraud. One OPM has reported that, as of November 1, 2005, there were 35 such class actions pending against it in the United States, as well as one each in Poland, Brazil and Israel. Plaintiffs in class action smoking and health lawsuits allege essentially the same theories of liability against the tobacco industry as those in the individual lawsuits. Other class action plaintiffs allege consumer fraud or violations of consumer protection or unfair trade statutes. Plaintiffs historically have had limited success in obtaining class certification, a prerequisite to proceeding as a class action lawsuit, because of the individual circumstances related to each smoker's election to smoke and the individual nature of the alleged harm. One OPM reports that class certification has been denied or reversed in 56 smoking and health class actions involving that OPM.

To date, plaintiffs have successfully maintained class certification in federal and state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, Minnesota, Missouri, New York, North Carolina, Ohio, Oregon, Washington and West Virginia. One OPM reports that 17 federal courts that have considered the issue, including two courts of appeals, have rejected class certification in smoking and health cases. Only one federal district court has certified a smoker class action (*In re Simon (II) Litigation*, discussed below); but that class was subsequently decertified by the United States Court of Appeals for the Second Circuit.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in United States District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases included individual and purported nationwide class action lawsuits alleging tobacco-related personal injuries, as well as healthcare cost recovery cases brought by union trust funds, an insurance plan and an asbestos fund. The suit sought to certify a nationwide class action to consolidate all punitive damage aspects of the pending cases for a single trial and to try the compensatory damage aspects of the pending claims separately. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consisted of all smokers diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease, after April 9, 1993. In May 2005, the U.S. Court of Appeals for the Second Circuit, in a unanimous opinion, decertified the class. Plaintiffs' motion for rehearing en banc was denied on August 8, 2005. Two of the 10 original cases, *Falise v. American Tobacco Co*., and *H.K. Porter Company, Inc. v. The American Tobacco Company* were dismissed in June 2001 and July 2001, respectively. Other plaintiffs who would have been part of the *Simon II* class remain free to pursue their own individual lawsuits.

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

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

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

Florida has enacted legislation capping the amount of the appeal bond necessary to stay execution of the punitive judgment pending appeal to the lesser of (i) the amount of punitive damages, plus twice the statutory rate of interest or (ii) 10% of a defendant's net worth, but in no case more than $100 million. Thirty-two other states have passed and several additional states are considering statutes limiting the amount of bonds required to file an appeal of an adverse judgment in state court. The limitation on the amount of such bonds generally ranges from $25 million to $150 million. Such bonding statutes allow defendants that are subject to large adverse judgments, such as cigarette manufacturers, to reasonably bond such judgments and pursue the appellate process. In six jurisdictions—Connecticut, Maine, Massachusetts, New Hampshire, Vermont and Puerto Rico—the filing of a notice of appeal automatically stays the judgment of the trial court.

One OPM has reported that the *Engle* plaintiffs believe the Florida appeal bond legislation is unconstitutional. In the event that a court of final jurisdiction were to declare the legislation unconstitutional, one OPM has stated that in a worst case scenario, it is possible that a judgment for punitive damages could be entered in an amount not capable of being bonded, resulting in an execution of the judgment before it could be set aside on appeal. On May 7, 2001, the trial court approved a stipulation (the "**Stipulation**") among Philip Morris, Lorillard and Liggett (the "**Stipulating Defendants**"), the plaintiffs, and the plaintiff class that provides that execution or enforcement of the punitive damages component of the *Engle* judgment will remain stayed against the Stipulating Defendants through the completion of all judicial review, regardless of a challenge, if any, to the Florida bond statute. Under the Stipulation, Philip Morris has placed $1.2 billion into an interest-bearing escrow account. Should Philip Morris prevail in its appeal of the case, this escrow amount is to be returned to Philip Morris, together with its $100 million appeal bond previously posted. In addition, Philip Morris, Lorillard and Liggett have also placed $500 million, $200 million (including Lorillard's appeal bond), and $9.72 million (including Liggett's appeal bond), respectively, into a separate interest-bearing escrow account for the benefit of the *Engle* class (the "**Guaranteed Amount**"). Even if the Stipulating Defendants prevail on appeal, the Guaranteed Amount will be paid to the court, and the court will determine how to allocate or distribute it consistent with the Florida Rules of Civil Procedure.

One *Engle* class member has already gone to trial. In *Lukacs v. Reynolds Tobacco*, a Florida appellate court granted the plaintiff the right to proceed before he died, but stated that any award in favor of the plaintiff would not be enforced until after the *Engle* appeal is decided. On June 11, 2002, a Florida jury awarded $37.5 million in compensatory damages to the plaintiff. On April 1, 2003, the Dade County Circuit Court granted in part the defendants' motion for remittitur, reducing the total award to $25.125 million. Because no final judgment will be entered until the *Engle* appeal is resolved, the defendants time to appeal the case has not yet begun to run. One OPM reports that it is a defendant in 11 separate cases pending in Florida courts in which the plaintiffs claim that they are members of the *Engle* class, that all liability issues associated with their claims were resolved in the earlier phases of the *Engle* proceedings, and that trials on their claims should proceed immediately. That OPM also reports that none of the cases in which plaintiffs contend they are members of the *Engle* class are expected to proceed until all appellate activity in *Engle* is concluded.

In October 1997, the tobacco industry defendants settled another class action case, *Broin I. Broin I* was brought in Florida state court by flight attendants alleging injuries related to ETS. See "Individual Plaintiffs' Lawsuits" above. The *Broin I* settlement established a protocol for the resolution of individual claims by class members against the tobacco companies. In addition to shifting the burden of proof to defendants as to whether ETS causes certain illnesses such as lung cancer and emphysema, the *Broin I* settlement required defendants to pay $300 million to be used to establish a foundation to sponsor research with respect to the early detection and cure of tobacco-related diseases. Individual members of the *Broin I* class retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. One OPM has reported that as of November 1, 2005, approximately 2,650 of these individual cases (known as *Broin II* cases) are pending in Florida. In October 2000, Judge Robert P. Kaye, the presiding judge of the original *Broin I* class action, held that the flight attendants will not be required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages, if any. The court also ruled that the trials of these suits will address whether the plaintiffs' alleged injuries were caused by their exposure to ETS and, if so, the amount of damages. The defendants' appeal of these rulings was dismissed by the intermediate appellate court on the basis that the appeal was premature and that the court lacked jurisdiction. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. That request was denied.

Seven *Broin II* cases have gone to trial since Judge Kaye's ruling in October 2000. Six of these cases have resulted in verdicts for the defendants: *Fontana* in June 2001, *Tucker* in June 2002, *Janoff* in October 2002, *Seal* in February 2003, *Routh* in October 2003 and *Swaty* in May 2005. Appeals are pending in some of these cases. On September 12, 2002, the plaintiff in the *Janoff* case filed a motion for a new trial, which the judge granted on January 8, 2003. The defendants appealed to the Florida Third District Court of Appeal, which, on October 27, 2004, affirmed the trial court's order granting a new trial. The defendants' motion for rehearing was denied. The defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court on June 17, 2005. In *Swaty*, the plaintiff filed a motion for a new trial on May 12, 2005, which was denied on June 23, 2005. On May 17, 2005, the court entered a final judgment in favor of the defendants. The plaintiff's motion for a new trial was denied on June 23, 2005. The plaintiff filed a notice of appeal on July 21, 2005. The one plaintiff's verdict was returned in *French v. Philip Morris*. On June 18, 2002, the *French* jury awarded the plaintiff $5.5 million in damages, finding that the flight attendant's sinus disease was cause by ETS. On September 13, 2002, the judge reduced the award to $500,000. The defendants appealed the trial court's final judgment to the Florida Third District Court of Appeal on various grounds, the primary one being that under Judge Kaye's

October 2000 ruling, the burden of proof was erroneously shifted and the plaintiff was not required to show that the tobacco companies' cigarettes were defective, that the tobacco company defendants acted negligently or that a warranty was made and breached. In December 2004, the Florida Third District Court of Appeal affirmed the judgment awarding plaintiff $500,000 and directed the trial court to hold the defendants jointly and severally liable. In April 2005, the appellate court denied defendants' motion for a rehearing. On May 11, 2005, the defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court. Jurisdictional briefing is complete.

In *Scott v. American Tobacco Company, Inc.*, a Louisiana medical monitoring and/or smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and/or monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also choose to bring individual smoking and health lawsuits. On July 28, 2003, following the first phase of a trial, the jury returned a verdict in favor of the tobacco industry defendants on the medical monitoring claim and found that cigarettes were not defective products. The jury found against the defendants, however, on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On March 31, 2004, phase two of the trial began to address the scope and cost of smoking cessation programs. On May 21, 2004, the jury returned a verdict in the amount of $591 million ($590 million plus prejudgment interest accruing from the date the suit commenced) on the class's claim for a smoking cessation program. On July 1, 2004, the judge upheld the jury's verdict and awarded the plaintiffs prejudgment interest, which, as of November 1, 2005, totals $384 million. On August 31, 2004, the defendants' motion for judgment notwithstanding the verdict or, in the alternative, for a new trial was denied. On September 29, 2004, pursuant to a stipulation of the parties, the defendants posted a $50 million bond (pursuant to legislation that limits the amount of the bond to $50 million collectively for MSA signatories) and noticed their appeal, which is pending. Under the terms of the stipulation, the plaintiffs reserved the right to contest the constitutionality of the bond cap law.

In August 2000, a West Virginia state court conditionally certified, only to the extent of medical monitoring, in *In re Tobacco Litigation* (formerly known as *Blankenship*), a class of West Virginia residents. The plaintiffs proposed that the class include all West Virginia residents who (1) on or after January 1, 1995, smoked cigarettes supplied by defendants; (2) smoked at least a pack a day for five years without having developed any of a specified list of tobacco-related illness; and (3) do not receive healthcare paid or reimbursed by the state of West Virginia. The trial began in January 2001. On January 25, 2001, the trial court granted a motion for a mistrial, ruling that the plaintiffs had improperly introduced testimony about addiction to smoking as a basis for claiming damages. In March 2001, the court denied the defendants' motion to decertify the class. The retrial began in September 2001, and on November 14, 2001 the jury returned a verdict that defendants were not liable for funding the medical monitoring program. On July 18, 2002, the plaintiffs petitioned the Supreme Court of West Virginia for leave to appeal, which was granted on February 25, 2003. The Supreme Court of West Virginia affirmed the judgment for the defendants on May 6, 2004. On July 1, 2004, the class's petition for rehearing was denied. The plaintiffs did not seek review by the United States Supreme Court.

Approximately 1,009 cases against tobacco industry defendants are pending in a single West Virginia court in a consolidated proceeding. The West Virginia court has scheduled a single trial for these consolidated cases, but it has certified a question to the Supreme Court of Appeals of West Virginia requesting a determination of the extent to which the claims in these individual cases can be consolidated in a single trial. On December 2, 2005, the Supreme Court of Appeals of West Virginia held that the Due Process Clause of the 14th Amendment, as interpreted by *State Farm v. Campbell*, does not preclude a bifurcated trial plan in which a punitive damages multiplier is established prior to compensatory damages.

In *Daniels v. Philip Morris*, a California state court case, the court certified a class comprised of individuals who were minors residing in California, who were exposed to defendants' marketing and advertising activities, and who smoked one or more cigarettes within the applicable time period. Certification was granted as to plaintiff's claims that defendants violated the state's unfair business practice laws. On September 12, 2002, the trial court judge granted the defendants' motion for summary judgment on First Amendment and preemption (Federal Cigarette Labeling and Advertising Act) claims. In November 2002, the court confirmed its earlier rulings granting defendant's motion for summary judgment. The plaintiffs filed a petition for review with the California Supreme Court. On February 26, 2005, the California Supreme Court granted the petition. Briefing by the parties is complete. The Attorney General of the State has filed an amicus curiae brief in support of the plaintiffs' position.

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

Altria has reported that, as of November 1, 2005, there were 25 putative class actions pending against Philip Morris in the United States on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights, Merit Lights and Cambridge Lights. These actions allege, among other things, that the use of the terms "Lights" and/or "Ultra Lights" constitutes deceptive and unfair trade practices and seek injunctive and equitable relief, including restitution. Classes have been certified in cases pending in Illinois, Massachusetts, Minnesota and Missouri, and in two cases pending in Ohio. Philip Morris has appealed or otherwise challenged these class certification orders. Additionally, an appellate court in Florida has overturned a class certification by a trial court in that state, and the plaintiffs have petitioned the Florida Supreme Court for further review. The Florida Supreme Court has stayed further proceedings pending its decision in the *Engle* case.

In one of these cases, *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris, Inc.*), a Madison County Illinois state court judge certified a class comprised of all residents of Illinois who purchased and consumed Cambridge Lights and Marlboro Lights within a specified time period but who do not have a claim for personal injury resulting from the purchase or consumption of cigarettes. The plaintiffs in the *Price* case alleged consumer fraud claims and sought economic damages in the form of a refund of purchase costs of the cigarettes. On March 21, 2003, after a non-jury trial, the trial court judge ruled in favor of the plaintiffs, ordering Philip Morris to pay \$10.1 billion (\$7.1 billion in compensatory damages, \$3.0 billion in punitive damages) to the State of Illinois, and \$1.78 billion in plaintiff lawyer fees to be paid from the \$10.1 billion. The court also stayed execution of the judgment for 30 days.

After entry of the judgment on March 21, 2003, Philip Morris had 30 days within which to file a notice of appeal. Under Illinois state court rules applicable at the time, the enforcement of a trial court's money judgment may be stayed only if, among other things, an appeal bond in an amount sufficient to cover the amount of the judgment, interest and costs is posted by a defendant within the 30-day period during which an appeal may be taken. With the approval of the trial court, such 30-day period may be extended for up to an additional 15 days. The trial court judge initially set the bond in the amount of $12 billion. Because of the difficulty of posting a bond of that magnitude, Philip Morris pursued various avenues of relief from the $12 billion bond requirement. In April 2003, the judge reduced the amount of the appeal bond. He ordered the bond to be secured by $800 million, payable in four equal quarterly installments beginning in September 2003, and a pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris to be placed in an escrow account pending resolution of the case. The plaintiffs appealed the judge's order reducing the amount of the bond. On July 14, 2003, the Illinois Fifth District Court of Appeals ruled that the trial court had exceeded its authority in reducing the bond and ordered the trial judge to reinstate the original bond. On September 16, 2003, the Illinois Supreme Court upheld the reduced bond set by the trial court and agreed to hear Philip Morris' appeal without the need for intermediate appellate court review. On December 15, 2005, the Illinois Supreme Court reversed the trial court's judgment and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the United States. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. It has been reported that the plaintiffs have filed a motion asking the court to reconsider its decision. It is possible that the plaintiffs will seek further appeals and/or rehearings. No assurance can be given that that such appeals and/or rehearings will not be granted or decided in the plaintiffs' favor.

Madison County Illinois courts have certified similar classes in *Turner v. R.J. Reynolds Tobacco Co*. and *Howard v. Brown & Williamson*. In *Turner*, for example, the state court judge certified a class defined as "[a]ll persons who purchased defendants' Doral Lights, Winston Lights, Salem Lights and Camel Lights, in Illinois, for personal consumption, between the first date that defendants sold Doral Lights, Winston Lights, Salem Lights and Camel Lights through the date the court certifies this suit as a class action…." On June 6, 2003, Reynolds Tobacco filed a motion to stay the case pending Philip Morris' appeal of the *Price* case. On July 11, 2003, the court denied the motion, and Reynolds Tobacco appealed to the Illinois Fifth District Court of Appeals. The Court of Appeals denied this motion on October 17, 2003. On October 20, 2003, the trial judge ordered that the case be stayed for 90 days, or pending the result of the *Price* appeal. The order stated that a hearing would be held at the end of the 90-day period to determine if the stay should be continued. However, on October 24, 2003, a justice on the Illinois Supreme Court ordered an emergency stay of all proceedings pending review by the entire Illinois Supreme Court of Reynolds Tobacco's emergency stay order request filed on October 15, 2003. On November 5, 2003, the Illinois Supreme Court granted Reynolds Tobacco's motion for a stay pending the court's final appeal decision in *Price*. The *Howard* case was also stayed by order of the trial judge, although the plaintiffs have appealed this stay order to the Illinois Fifth District Court of Appeals. Both cases still remain stayed, notwithstanding the *Price* decision.

On December 31, 2003, a Missouri state court judge certified a similar class in *Collora v. R.J. Reynolds Tobacco Co*. On January 14, 2004, Reynolds Tobacco removed the case to the United States District Court for the Eastern District of Missouri. On September 30, 2004, the case was remanded to the Circuit Court for the City of St. Louis. In August 2004, Massachusetts' highest court affirmed the class certification order in another "lights" case, *Aspinall v. Philip Morris Cos*. In March 2005, a Minnesota appeals court declined to review a state trial court's denial of class certification in a "lights" case, *Curtis v. Philip Morris*. In May 2005, also in Minnesota, a state court judge dismissed in its entirety a similar case, *Dahl v. R.J. Reynolds Tobacco Company*, ruling that the claims of the plaintiffs conflicted with the federal Cigarette Labeling and Advertising Act. On July 11, 2005, the plaintiffs filed a notice of appeal with the Minnesota Court of Appeals.

According to Reynolds American, six other similar "lights" cases are pending against Reynolds Tobacco, although no classes have yet been certified in any of those cases. In August 2005, the Missouri Court of Appeals, Eastern District, affirmed the class certification order in *Craft v. Philip Morris Cos*. On August 31, 2005, a Louisiana federal district court ruled in a proposed class action, *Sullivan v. Philip Morris*, that the Federal Cigarette Labeling and Advertising Act ("**FCLAA**") does not preempt plaintiffs' claims of a breach of express warranty and certain state law remedies with respect to manufacturing defects. On September 14, 2005, the same district court ruled in a proposed class action, *Brown v. Brown & Williamson*, that the FCLAA does not preempt plaintiffs' fraudulent misrepresentation/concealment and defective product claims. On June 9, 2005, a proposed "lights" class action was filed in a federal District Court in New Mexico. On June 27, 2005, a similar class action was filed in a Kansas state court against Philip Morris and its parent Altria. Philip Morris and Altria are reportedly seeking to have the Kansas case transferred to federal court in Kansas, and that on August 13, 2005, three individuals filed a similar class action in the U.S. District Court for the District of Maine against the same defendants.

In *Schwab v. Philip Morris USA, Inc.*, smokers of "Lights" cigarettes filed a purported class action suit in the United States District Court for the Eastern District of New York against the OPMs and their parent companies, Liggett and certain other entities. Plaintiffs allege that the defendants formed an "association-in-fact" enterprise, in violation of the federal RICO statute, to defraud the public into believing that "light" cigarettes were healthier alternatives to regular cigarettes. Plaintiffs seek to certify a nationwide class of smokers comprising all purchasers of "light" cigarettes manufactured by the defendants since the 1970's. Oral argument on the plaintiffs' motion for class certification occurred on September 12, 2005. The defendants filed a motion to deny class certification and to dismiss the complaint, asserting that the plaintiffs' request—that any determination as to damages payable to a certified class be allocated among class members on a "fluid recovery" basis—is illegal. On November 14, 2005, the court denied the defendants' motion, ruling that the plaintiffs' request for "fluid recovery" is not illegal and does not require denial of class certification or dismissal of the action.

On May 23, 2001, a lawsuit was filed in the United States District Court for the District of Columbia styled *Sims v. Philip Morris Incorporated*, which sought class action status for millions of youths who began smoking cigarettes before they were legally allowed to buy cigarettes. Plaintiffs sought to recover moneys that underage smokers spent on cigarettes before they were legally allowed to buy cigarettes, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleged that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising. In February 2003, the court denied plaintiffs' motion for class certification.

On April 3, 2002, in *Deloach v. Philip Morris*, a federal district court in North Carolina granted class certification to a group of tobacco growers and quota-holders from Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee. The class accused cigarette manufacturers of conspiring to set prices offered for tobacco in violation of antitrust laws. In June 2002, the defendants' petition to the Fourth Circuit Court of Appeals seeking permission to appeal the class certification was denied. In May 2003, the plaintiffs reached a settlement with all of the tobacco industry defendants other than Reynolds Tobacco. The settling defendants agreed to pay $210 million to the plaintiffs, to pay plaintiffs' attorney fees of $75.3 million as set by the court and to purchase a minimum amount of U.S. leaf for ten years. The case continued against Reynolds Tobacco. On April 22, 2004, after the trial began, the parties settled the case. Under the settlement, Reynolds Tobacco has paid $33 million into a settlement fund, which, after deductions for attorneys' fees and administrative costs, will be distributed to the class pending final settlement approval. Reynolds Tobacco has also agreed to purchase a minimum amount of U.S. leaf for the next ten years. On March 21, 2005, the court approved the settlement and dismissed the suit.

It has been reported that a lawsuit was filed on January 19, 2006 in the United States District Court for the Eastern District of New York against Philip Morris to require Philip Morris to pay for low dose CAT scans (on an annual basis) for a class of smokers over the age of 50 who have been smoking at least a pack of Marlboro a day for 20 years and have not been diagnosed with lung cancer.

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

Altria has reported that as of November 1, 2005, there were approximately 1,157 individual plaintiff smoking and health cases pending in the United States against it (many of which cases include other tobacco industry defendants), including 928 cases pending before a single West Virginia state court in a consolidated proceeding. In addition, approximately 2,650 additional individual cases (referred to herein as the *Broin II* cases) are pending in Florida by individual current and former flight attendants claiming personal injury allegedly related to ETS in airline cabins. The individuals in the *Broin II* cases are limited by the settlement of a previous class action lawsuit, *Broin v. Philip Morris* (known as *Broin I*), to the recovery of compensatory damages only, and are precluded from seeking or recovering punitive damages. As a result of the settlement, however, the burden of proof as to whether ETS causes certain illnesses such as lung cancer and emphysema was shifted to the tobacco industry defendants. To date, seven individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. The defendants' appeal in that case is pending. See also "Class Action Lawsuits" below.

In the last ten years, juries have returned verdicts in individual smoking and health cases against the tobacco industry, including one or more of the PMs. Thus far, a number of those cases have resulted in significant verdicts against the defendants and some have been appealed, some have been overturned and others have been affirmed. All post-trial motions and appeals have been exhausted and plaintiffs have been paid in only four cases.

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

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

- In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in actual damages and $79.5 million in punitive damages. The trial judge subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of the punitive damages award was reinstated by the Oregon Court of Appeals. The Oregon Supreme Court declined to review the reinstated punitive damage award and Philip Morris petitioned the United States Supreme Court for further review. In October 2003, the United States Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of *State Farm v. Campbell*. In June 2004, the Oregon Court of Appeals reinstated the punitive damages award. In December 2004, the Oregon Supreme Court granted Philip Morris' petition for review of the case. On February 2, 2006 the Oregon Supreme Court affirmed the Court of Appeals decision, holding that the punitive damage award does not violate due process guarantees of the United States Constitution. Philip Morris has stated that it will again seek review of this case by the United States Supreme Court as a violation of the principles set forth in *State Farm v. Campbell* regarding the permissible size of punitive damage awards relative to compensatory damage awards.

- In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $2.25 million in damages. An appellate court has remanded the case for a determination of the date of injury to determine whether a statutory cap on non-economic damages applies.

- In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the plaintiffs and found the defendants, including Philip Morris and Reynolds Tobacco, liable for negligent product design and fraud, and awarded $1.72 million in compensatory damages and $20 million in punitive damages. Both damage awards were upheld by the trial judge, who denied the defendants' post-verdict challenge. The defendants appealed the verdict. In April 2004, the California Court of Appeal reversed the judgment and remanded the case for a new trial. The plaintiff's motion for rehearing was denied on April 29, 2004. It is not known whether the plaintiffs will retry the case.

- In October 2000, a Tampa, Florida jury in *Jones v. R.J. Reynolds Tobacco Co.* found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages; the jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002 the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff filed for permission to appeal to the Florida Supreme Court. On December 9, 2002, the Supreme Court of Florida issued an order to show cause as to why Jones' notice of appeal should not be treated as a notice to invoke discretionary jurisdiction. On April 27, 2005 the Florida Supreme Court denied the plaintiff's notice of appeal without prejudice. On May 25, 2005 the plaintiff served an amended notice of intent to invoke discretionary jurisdiction. On June 22, 2005 the defendants filed their response. The motion has not yet been decided.

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

- In June 2001, in *Boeken v. Philip Morris Incorporated*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product alleged by the plaintiff. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award was reduced to $100 million post-trial. Philip Morris appealed. In September 2004, the California Second District Court of Appeal further reduced the punitive damage award to $50 million, but otherwise affirmed the judgment entered in the case. In October 2004, the Court of Appeal granted the parties' motions for rehearing and, in April 2005, reaffirmed the amount of the September 2004 ruling. On August 10, 2005, the California Supreme Court denied Philip Morris's request for review. Philip Morris has reported that it has not yet paid this judgment, but that it has reserved $56 million therefor.

- In December 2001, a Florida state court jury awarded the plaintiff $165,500 in compensatory damages but no punitive damages in *Kenyon v. R.J. Reynolds Tobacco Co*. Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which, on May 30, 2003, affirmed per curium (that is, without writing an opinion) the trial court's judgment in favor of the plaintiff. Reynolds Tobacco sent the plaintiff's counsel the amount of the judgment plus accrued interest ($196,000) in order to pursue further appeals. On September 5, 2003, Reynolds Tobacco petitioned the Florida Supreme Court to require the Second District Court of Appeal to write an opinion. On April 22, 2004, the Florida Supreme Court denied the petition. On January 26, 2004, the United States Supreme Court denied Reynolds Tobacco's petition for a writ of certiorari, thus leaving the jury verdict intact. The only issue remaining in this case is the amount of attorneys' fees to be awarded to plaintiff's counsel.

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

- In March 2002, a Portland, Oregon jury awarded approximately $168,500 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Incorporated*. The trial judge subsequently reduced the punitive damages awarded to $100 million. Philip Morris and the plaintiffs have each appealed.

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

- In October 2002, in *Bullock v. Philip Morris, Inc.*, a Los Angeles, California jury awarded a smoker $850,000 in compensatory damages. In October 2002, the same jury awarded the plaintiff $28 billion in punitive damages. In December 2002, the trial judge reduced the punitive damage award to $28 million. Philip Morris and the plaintiff have each appealed.

- In April 2003, in *Eastman v. Philip Morris*, a Florida jury awarded a smoker $3.255 million in damages, after reducing the award to reflect the plaintiff's partial responsibility. Defendants Philip Morris and B&W appealed to the Second District of Florida Court of Appeal. In May 2004, the Second District Court of Appeal rejected the appeal in a per curium decision (that is, without a written opinion). The defendants' petition for a written opinion and rehearing was denied on October 14, 2004, and that ruling is not subject to review by the Florida Supreme Court. On October 29, 2004, Philip Morris and Reynolds Tobacco, due to its obligation to indemnify B&W, satisfied their respective portions of the judgment.

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

- In November 2003, in *Thompson v. Philip Morris, Inc.*, a Missouri jury returned a split verdict, awarding approximately $1.6 million in compensatory damages to the plaintiff and an additional $500,000 in damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W and the remaining 50% to the plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. The defendants appealed to the Missouri Court of Appeals for the Western District on March 8, 2004. The defendants' opening appellate brief was filed on May 23, 2005. The appeal is pending.

- In December 2003, in *Frankson v. Brown & Williamson*, a New York jury awarded the plaintiff $350,000 in compensatory damages and $20 million in punitive damages. On June 22, 2004, the trial judge granted a new trial unless the parties agree to an increase in compensatory damages to $500,000 and a decrease in punitive damages to $5 million. On January 21, 2005, the plaintiff stipulated to the court's reduction in the amount of punitive damages. Defendants have appealed.

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

- In October 2004, in *Arnitz v. Philip Morris, Inc.*, a Florida jury returned a verdict in favor of the plaintiff, who claims that as a result of his smoking he developed lung cancer and emphysema. The jury awarded a total of $240,000 in compensatory damages. Philip Morris, the sole defendant in the case, has appealed to the Florida Second District Court of Appeals.

- In February 2005, in *Smith v. Brown & Williamson*, a Missouri state court jury returned a split verdict, finding in favor of the defendant on counts of fraudulent concealment and conspiracy and in favor of the plaintiffs on a negligence count. The jury awarded the plaintiffs $500,000 in compensatory damages and $20 million in punitive damages. On March 10, 2005, the defendant filed a motion for judgment notwithstanding the verdict or, in the alternative, for a new trial. On May 23, 2005, the trial court denied defendant's motion and on June 1, 2005, the defendant appealed.

- In March 2005, in *Rose v. Philip Morris*, a New York jury awarded $3.42 million in compensatory damages against B&W and Philip Morris. The jury also returned a punitive damages award totaling $17.1 million against Philip Morris. Post trial motions were filed on May 27, 2005 and Philip Morris announced that it would file motions challenging the verdict. Briefing is complete.

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

Healthcare Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals and others, are seeking reimbursement of healthcare cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. Altria has reported that as of November 1, 2005, there were six healthcare cost recovery actions pending against Philip Morris in the United States. In addition, it has been reported that on August 4, 2005, a national senior citizens' organization has filed a lawsuit against cigarette manufacturers under the federal "Medicare as Secondary Payer" statute, which permits Medicare beneficiaries or others to bring actions on behalf of Medicare to recover healthcare costs paid by Medicare for which another party may be liable. The plaintiffs are reportedly seeking to recover more than $60 billion in alleged Medicare spending on treatment of smoking related illnesses since 1999. This lawsuit reportedly does not seek to recover Medicare payments in Florida, where a similar suit has been filed. The Florida case was dismissed on July 26, 2005 and the plaintiffs have appealed.

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

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

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

A number of foreign governmental entities have filed suit in state and federal courts in the United States against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. Such suits have been brought in the United States by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. Thirty-four of these suits have been dismissed and two remain pending. In addition to these cases brought in the United States, healthcare cost recovery actions have also been brought in Israel, the Marshall Islands (where the suit was dismissed), Canada, France and Spain. In September 2003, the case pending in France was dismissed and the plaintiff has appealed. In May 2004, the case pending in Spain was dismissed and the plaintiff has appealed. Other governmental entities have stated that they are considering filing such actions. On September 29, 2005, the Supreme Court of Canada upheld legislation passed in 1998 by the province of British Columbia allowing the provincial government to seek damages from tobacco companies for healthcare costs incurred during the past 50 years, as well as for future illness-related expenses in connection with tobacco use. The legislation also lightens the required burden of proof and curtails certain traditional defenses in civil suits. Other provinces are reported to have already adopted or are expected to adopt similar legislation.

In September 1999, the United States government filed a lawsuit in the United States District Court for the District of Columbia against the OPMs, certain related parent companies and two tobacco industry research and lobbying organizations, seeking medical cost recovery for federal funds spent to treat alleged tobacco-related illnesses and asserting violation of RICO. In September 2000, the trial court dismissed the government's medical cost recovery claims, but permitted discovery to proceed on the government's claims for relief under RICO. The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In June 2004, the trial court certified that order for immediate appeal, and in July 2004, the United States Court of Appeals for the District of Columbia agreed to hear the appeal on an expedited basis. On February 4, 2005, the appeals court, in a 2-1 decision, ruled that disgorgement is not an available remedy in this case. This ruling eliminated the government's claim for $280 billion and limits the government's potential remedies principally to forward-looking relief, including funding for anti-smoking programs. The government appealed this ruling to seek a rehearing en banc. On April 20, 2005, the appeals court denied the government's appeal. On July 18, 2005, the government appealed the ruling with regard to the $280 billion disgorgement decision to the United States Supreme Court. On October 17, 2005 the U.S. Supreme Court, without comment, denied the appeal.

In addition to the claim for disgorgement, the government seeks relief consisting of, among other things, (i) prohibitory injunctions (including prohibitions on committing acts of racketeering, making false or misleading statements about cigarettes, and on youth marketing); (ii) disclosure of documents concerning the health risks and addictive nature of smoking, the ability to develop less hazardous cigarettes and youth marketing campaigns; (iii) mandatory corrective statements about the health risks of smoking and the addictive properties of nicotine in future marketing campaigns; and (iv) funding of remedial programs (including research, public education campaigns, medical monitoring programs, and smoking cessation programs). The trial phase of the case concluded on June 9, 2005. In its closing argument and submissions, the government requested that the tobacco industry be required to fund an up to ten-year, $14 billion smoking cessation program. The government has reportedly also asked the court to appoint a lawyer as monitor with power to order the defendants to sell off their research and development facilities related to developing so-called safer cigarettes. The monitor would also have power to review the business policies of the defendants. The government has also reportedly requested that restrictions be placed on the defendants' ability to sell their cigarette businesses and that the defendants be compelled to run public advertisements regarding the dangers of smoking. It has been reported that the defendants have filed a motion to dismiss the government's request for the $14 billion award, arguing that the award was barred by the February 4, 2005 appellate decision. On July 22, 2005, the District Court judge granted the motion made under Federal Rule of Civil Procedure 24 by six public interest groups to intervene in this action for the very limited purpose of being heard on the issue of permissible and appropriate remedies in this case, should the government prevail on its claims with respect to smoking cessation programs.

In January of 2001, the Canadian Province of British Columbia enacted the Damages and Healthcare Costs Recovery Act (the "**HCCR Act**"). The HCCR Act authorizes an action by the government of British Columbia against a manufacturer of tobacco products for the recovery by the government of the present value of past and reasonably expected future healthcare expenditures incurred by the government in treating British Columbians with diseases caused by exposure to tobacco products, where such exposure was caused by a manufacturer's tort in British Columbia or a breach of a duty owed to persons in British Columbia. The HCCR Act allows the government to bring such action for expenditures related to a particular individual or on an aggregate basis for a population of persons. In an action brought on an aggregate basis, the Act does not require the government identify a particular person or to prove particular injury, healthcare costs or causation of harm with respect to any particular person. Where the government proves in an aggregate claim with respect of a type of tobacco product that a manufacturer breached a legal duty owed to persons who have been or might become exposed to the tobacco product and that exposure to the tobacco product can cause or contribute to a disease, the court is required to presume that (1) the population of persons who were exposed to the tobacco product would not have been exposed to the product but for the breach of duty and (2) such exposure caused or contributed to disease or risk of disease in such population of persons. In such cases, the court is required to determine on an aggregate basis the cost of healthcare benefits provided after the date of the breach of duty and to assess liability among defendants based on the proportion of the aggregate cost equal to each defendant's market share in the type of tobacco product. Statistical information and information derived from epidemiological and other relevant studies is admissible as evidence under the HCCR Act to establish causation and for quantifying damages in an action brought by the government under the HCCR Act or in an action brought by a class of persons under Canada's class action statute.

Subsequently to the enactment of the HCCR Act, the government of British Columbia brought an action under the HCCR Act against certain foreign and domestic tobacco manufacturers, including Philip Morris International, a subsidiary of Altria. The defendants challenged the constitutionality of the HCCR Act and in a decision dated June 5, 2003, British Columbia's trial level court held that the HCCR Act was unconstitutional as exceeding the territorial jurisdiction of the Province. On appeal, British Columbia's highest court reversed the lower court in a decision dated May 20, 2004, holding that the HCCR Act was constitutional. The matter was appealed to the Canadian Supreme Court, Canada's highest court. By a unanimous decision dated September 29, 2005 the Canadian Supreme Court affirmed the lower court, holding that the HCCR Act was constitutional. In the decision, the court also vacated the stay of proceedings and the action will now continue. While the judgment only applies to British Columbia, it is expected that other provincial governments may follow suit. It has been reported that Newfoundland has enacted and Saskatchewan and Nova Scotia are considering enacting legislation similar to the HCCR Act.

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

- *Asbestos Contribution Cases*. These cases, which have been brought against cigarette manufacturers on behalf of former asbestos manufacturers, their personal injury settlement trusts and insurers, seek, among other things, contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking. In January 2005, one case was dismissed; currently, one case (*Fibreboard Corp. v. R.J. Reynolds Tobacco Co.*) remains pending.

- *Cigarette Price-Fixing Cases*. According to one OPM, as of August 1, 2005, there were two cases pending against domestic cigarette manufacturers in Kansas (*Smith v. Philip Morris*) and New Mexico (*Romero v. Philip Morris*), alleging that defendants conspired to fix cigarette prices in violation of antitrust laws. The plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision in the Romero case.

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

September 13, 2005, the Second Circuit Court of Appeals found that *Pasquantino* was inapplicable to the case and affirmed its earlier decision that the revenue rule bars foreign sovereigns' civil claims for recovery of lost tax revenue and law enforcement costs related to cigarette smuggling. One OPM has stated that it is possible that future litigation related to cigarette contraband issues may be brought.

- *Patent Litigation*. In 2001 and 2002, Star Scientific, Inc. ("**Star**") filed two patent infringement actions against Reynolds Tobacco in the United States District Court for the District of Maryland. Such actions have been consolidated. Reynolds Tobacco filed various motions for summary judgment, which were all denied. Reynolds Tobacco has also filed counterclaims seeking a declaration that the claims of the two Star patents in dispute are invalid, unenforceable and not infringed by Reynolds Tobacco. Between January 31, 2005 and February 8, 2005, the District Court held a first bench trial on Reynolds Tobacco's affirmative defense and counterclaim based upon inequitable conduct. The District Court has not yet issued a ruling on this issue. Additionally, in response to the court's invitation, Reynolds Tobacco filed two summary judgment motions on January 20, 2005. The District Court has indicated that it will rule on Reynolds Tobacco's two pending summary judgment motions and the issue of inequitable conduct at the same time. The District Court has not yet set a trial date for the remaining issues in the case.

- *Vermont Litigation*. On July 22, 2005, Vermont announced that it had sued Reynolds Tobacco for using false and misleading advertising to promote its "Eclipse" brand of cigarettes. The lawsuit charges that Reynolds Tobacco's advertising, which claims that smoking Eclipse cigarettes is less harmful than smoking other brands of cigarettes, violated Vermont's consumer protection statutes. According to the Vermont Attorney General, the offices of Attorneys General across the country, including California, Connecticut, the District of Columbia, Idaho, Illinois, Iowa, Maine, New York and Tennessee, have actively participated in the investigation leading up to this lawsuit and will continue to assist Vermont in it.

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

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

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

THE GLOBAL INSIGHT CONSUMPTION REPORT

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

General

Global Insight has prepared a report, dated February 3, 2006 (the "**Global Insight Consumption Report**") for TSASC on the consumption of cigarettes in the United States from 2004 through 2042 entitled, "A Forecast of U. S. Cigarette Consumption (2004-2042) for TSASC, Inc." Global Insight is an internationally recognized econometric and consulting firm of over 200 economists in 16 offices worldwide. Global Insight is a privately held subsidiary of Global Insight Inc., a publicly traded company which is a provider of financial, economic and market research information.

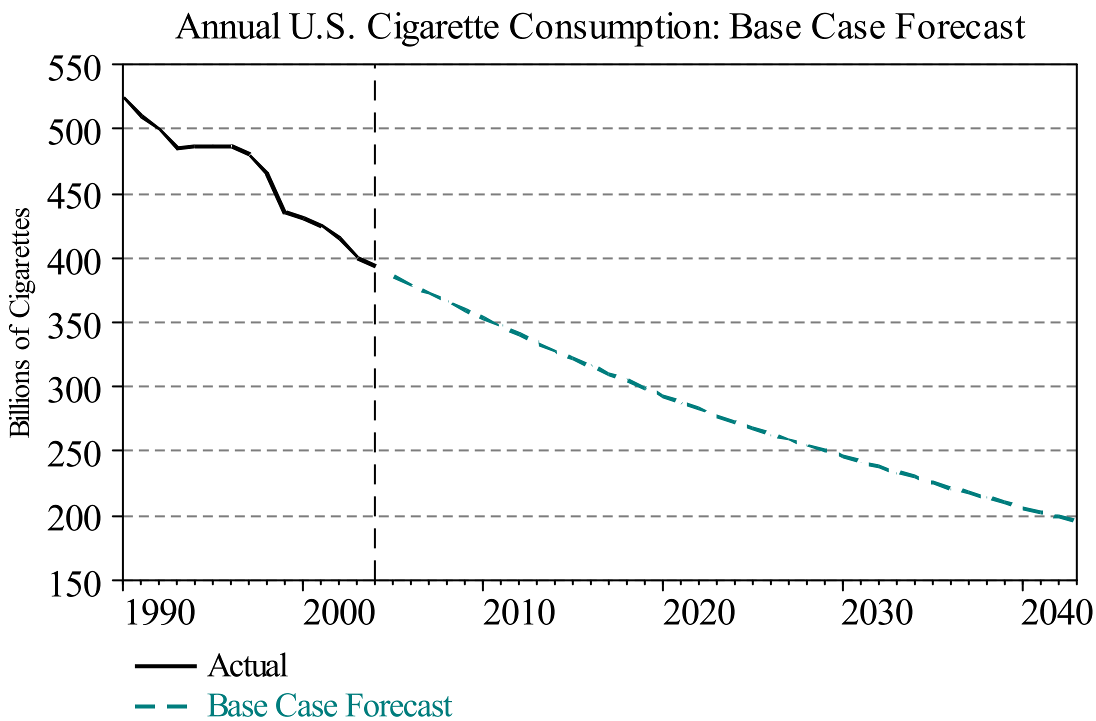
Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2003. Global Insight constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences), Global Insight employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.40% per year holding other recognized significant factors constant.

Global Insight's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2004 through 2042 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total United States cigarette consumption in 2042 will be 199 billion cigarettes (approximately 10 billion packs), a 50% decline from the 2003 level. After 2003, the rate of decline in total cigarette consumption is projected to moderate and average less than 2% per year. From 2004 through 2042, the average annual rate of decline is projected to be 1.78%. On a per capita basis, consumption is forecast to fall during the same period at an average annual rate of 2.55%. Total consumption of cigarettes in the United States is forecast to fall from an estimated 393 billion in 2004 to 385 billion in 2005, under 300 billion by 2019, and to under 200 billion by 2042, as set forth in the following table. The Global Insight Consumption Report states that Global Insight believes that the assumptions on which the Base Case Forecast is based are reasonable.

Global Insight Base Case Forecast of Cigarette Consumption

Year	Cigarettes (billions)	Year	Cigarettes (billions)
2004	393.00	2024	272.80
2005	385.10	2025	268.13
2006	378.67	2026	263.58
2007	372.43	2027	259.12
2008	366.17	2028	254.77
2009	359.37	2029	250.49
2010	353.07	2030	246.28
2011	346.82	2031	242.04
2012	340.38	2032	237.93
2013	333.89	2033	233.89
2014	327.38	2034	229.87
2015	321.60	2035	225.49
2016	315.88	2036	221.53
2017	310.02	2037	217.67
2018	304.28	2038	213.95
2019	298.49	2039	210.08
2020	293.13	2040	206.33
2021	287.77	2041	202.69
2022	282.63	2042	198.98
2023	277.53		

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



The Global Insight Consumption Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2042 total United States consumption could be as low as 185 billion or as high as 211 billion cigarettes. In addition, the Global Insight Consumption Report presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

Comparison with Prior Forecasts

In August 2002, Global Insight (then DRI•WEFA, Inc.) presented another similar study "A Forecast of U.S. Cigarette Consumption (2001-2042)." Its long run conclusions were quite similar to those in the Global Insight Consumption Report. The Global Insight Consumption Report forecast of consumption for the year 2042 is 5.3% less than that of the 2002 study, 199.0 billion versus 210.1 billion. At that time Global Insight projected that 2003 consumption would be 394 billion cigarettes, a 3.4% decline from 2001. The USDA however has since estimated that 2000 consumption levels, at 430 billion, were higher than reported at that time. Consumption levels for 2002 were then estimated by USDA at 415 billion cigarettes. Global Insight incorporated this and other new data available into the Global Insight Consumption Report forecast. The new data available, now for over five years after the MSA, has allowed Global Insight to re-estimate and update the econometric coefficients of its consumption model. In doing so, Global Insight modified, on the basis of the statistical evidence through 2003, two important parameters used in its forecast model. First, Global Insight found that, when taking into account the consumption response to the large price increases from 1999 to 2003, the price elasticity of demand is slightly higher, at -0.33, than the -0.31 previously estimated. The implication is that each additional 10% increase in the real price of cigarettes will reduce consumption by 3.3%. Previously Global Insight's model had assumed a consumption response of 3.1% following a 10% price change. Second, the underlying trend decline in per-capita cigarette consumption has been found, also based on statistical evidence through 2003, to be 2.4% per year, slightly higher than the 2.3% per year assumed in the earlier report. The implications of these changes are to increase the long term rate of decline of consumption to 1.78% per year, from 1.69% as projected in 2002. The net result of all of these changes is that 2042 consumption is now projected to be 11 billion cigarettes lower than Global Insight's 2002 forecast.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004.

The following table sets forth United States domestic cigarette consumption for the seven years ended December 31, 2004. The data in this table vary from statistics on cigarette shipments in the United States. While the Cigarette Consumption Report is based on consumption, payments under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31	Consumption (Billions of Cigarettes)	Percentage Change
2004	393(*est.*)	-1.75%
2003	400	-3.61
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price elasticity of demand and price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trends over time, (vi) smoking bans in public places, (vii) nicotine dependence, and (viii) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to 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 Global Insight, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Global Insight's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify.

SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION

Introduction

The following discussion describes the methodology and assumptions used to calculate projections of Collections to be received by the Indenture Trustee (the "**Cash Flow Assumptions**"), as well as the methodology and assumptions used to structure the Sinking Fund Installments and Turbo Term Bond Maturities for the Series 2006-1 Bonds and calculate the projected Turbo Redemptions (the "**Bond Structuring Methodology**"). In addition, sensitivity analyses are provided which evaluate the impact of different consumption levels on Turbo Redemptions.

Cash Flow Assumptions

In calculating projections of Collections to be received by the Indenture Trustee, different assumptions of cigarette consumption in the United States, including the forecast developed by Global Insight described as the Base Case Forecast, were applied to calculate Annual Payments to be made by the PMs pursuant to the MSA. The calculations of Annual Payments required to be made were performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the relative market share for each of the PMs remains constant throughout the forecast period at 85.1% for the OPMs, 8.7% for the SPMs and 6.2% for the NPMs.* It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2006-1 Bonds.

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

Annual Payments

For each projection, the amount of Annual Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments in the amounts set out in the MSA, as follows.

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

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

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

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

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

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

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

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

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

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

Subsequent Participating Manufacturers. The Cash Flow Assumptions assume that the relative market share of the SPMs remains constant at 8.7%. Because the 8.7% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), the SPMs are assumed to make Annual Payments in each year.

State Allocation Percentage for the State. The amounts of Annual Payments after application of the Inflation Adjustment, the Volume Adjustment and the Previously Settled States Reduction for each year were multiplied by the State Allocation Percentage for New York (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.

Consent 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 assumed to be received by TSASC in each year.

Applicable Percentage of 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. The Pledged TSRs are the right, title and interest of TSASC in and to the Applicable Percentage of the Tobacco Assets, initially 37.40%, which is subject to reduction after June 1, 2024 if Cumulative Actual Turbo Redemptions equal or exceed the Cumulative Projected Turbo Redemptions as presented in the table below and as more fully described under "SECURITY FOR THE BONDS – Applicable Percentage of Pledged TSRs" herein.

Applicable Percentage of Pledged TSRs

	Cumulative Projected Turbo Redemptions	**Applicable Percentage**	**Effective Date of Applicable Percentage**
June 1, 2024	$996,165,000	30.10%	June 2, 2024
June 1, 2025	1,077,725,000	18.68	June 2, 2025
June 1, 2026	1,126,925,000	18.68	June 2, 2026
June 1, 2027	1,179,450,000	18.68	June 2, 2027
June 1, 2028	1,235,485,000	18.68	June 2, 2028
June 1, 2029	1,295,230,000	4.25	June 2, 2029
June 1, 2030	1,308,465,000	4.25	June 2, 2030
June 1, 2031	1,322,530,000	4.25	June 2, 2031
June 1, 2032	1,337,455,000	4.25	June 2, 2032 and thereafter

Interest Earnings

The Cash Flow Assumptions assume that the Indenture Trustee will receive ten days after April 15th TSASC's share of the Annual Payments owed by the PMs in 2006 and each year thereafter. Earnings are assumed at 4.0% per annum on the Annual Payments received by the Indenture Trustee until the applicable Distribution Date. Interest earnings have been assumed to begin accruing upon receipt by the Indenture Trustee of the Annual Payments.

Amounts on deposit in the Liquidity Reserve Account are assumed to be invested at the rate of 4.0% per annum.

Other Assumptions

Sinking Fund Installments. The schedules of Sinking Fund Installments for the Series 2006-1 Bonds are as indicated under "THE SERIES 2006-1 BONDS – Sinking Fund Installments" herein.

Maturity Dates of Series 2006-1 Bonds. The Series 2006-1 Bonds mature as set forth on the inside front cover hereof.

Liquidity Reserve Account. The Liquidity Reserve Account Requirement was established for the Series 2006-1 Bonds at $85,399,237.50. It has been assumed that no surety, guaranty or similar agreement will be deposited in lieu of cash in the Liquidity Reserve Account.

Operating Expense Assumptions. Annual operating expenses of TSASC have been assumed at the Operating Cap of $1,000,000 in 2006. In each year thereafter, the Operating Cap was assumed to be inflated at 3% per year. No operating expenses are assumed in excess of the annual Operating Cap and no arbitrage rebate expense was assumed since the projected yield on TSASC's investments does not exceed the arbitrage yield on the Series 2006-1 Bonds.

Issuance Date. The Series 2006-1 Bonds were assumed to be issued on February 8, 2006.

Interest Rates and Computation of Interest. The Series 2006-1 Bonds were assumed to bear interest at the rates set forth on the inside front cover hereof. Computation of interest was assumed to be made on the basis of a 360-day year consisting of twelve 30-day months.

Miscellaneous. The Cash Flow Assumptions assume that no Swap Payments are required to be made, that there is no optional redemption of the Bonds, that no Event of Default occurs, that no Lump Sum Payment, Partial Lump Sum Payment or Total Lump Sum Payment is received, that no Turbo Redemptions occur on any Distribution Date other than June 1, that no Additional Parity Bonds are issued and that there is no Mandatory Clean-up Call from balances in the Pledged Accounts until after June 1, 2033. It is further assumed that all Distribution Dates occur on the first day of each June and December, whether or not such date is a Business Day.

Bond Structuring Methodology

Cigarette Consumption

The Series 2006-1 Bonds have been structured utilizing the Global Insight Base Case Forecast. The following tables present the projections of Pledged TSRs to be received by the Indenture Trustee in each year through 2042 assuming the Applicable Percentage of Pledged TSRs remains at 37.40%, calculated in accordance with the Cash Flow Assumptions and using Global Insight's Base Case Forecast. Global Insight's Base Case Forecast for United States cigarette consumption is set forth under "GLOBAL INSIGHT CONSUMPTION REPORT" herein. See Appendix A hereto for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Consumption Report.

Projection of Pledged TSRs
Assuming the Applicable Percentage of Pledged TSRs is 37.40%* in Every Year

Year	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments by OPMs	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Total Adjusted Annual Payments by OPMs	Pledged Portion of OPM Annual Payments**	Pledged Portion of SPM Annual Payments**	Total Annual Payments of Pledged TSRs **
2006	378,670,000,000	322,248,170,000	$8,000,000,000	$1,941,741,289	($3,030,184,916)	($860,488,768)	$6,051,067,605	$77,027,609	$5,763,756	$82,791,365
2007	372,430,000,000	316,937,930,000	8,000,000,000	2,239,993,527	(3,236,534,980)	(871,930,589)	6,131,527,958	78,051,836	5,840,396	83,892,232
2008	366,170,000,000	311,610,670,000	8,139,000,000	2,591,450,817	(3,508,952,089)	(883,721,923)	6,337,776,805	80,677,300	6,022,226	86,699,526
2009	359,370,000,000	305,823,870,000	8,139,000,000	2,913,364,342	(3,735,529,418)	(895,388,572)	6,421,446,353	81,742,379	6,101,730	87,844,109
2010	353,070,000,000	300,462,570,000	8,139,000,000	3,244,935,272	(3,983,321,593)	(905,640,893)	6,494,972,787	82,678,340	6,171,596	88,849,936
2011	346,820,000,000	295,143,820,000	8,139,000,000	3,586,453,330	(4,232,340,051)	(916,960,416)	6,576,152,863	83,711,729	6,248,734	89,960,463
2012	340,380,000,000	289,663,380,000	8,139,000,000	3,938,216,930	(4,491,655,863)	(928,273,599)	6,657,287,468	84,744,539	6,325,829	91,070,368
2013	333,890,000,000	284,140,390,000	8,139,000,000	4,300,533,438	(4,766,865,523)	(938,933,191)	6,733,734,723	85,717,682	6,398,470	92,116,151
2014	327,380,000,000	278,600,380,000	8,139,000,000	4,673,719,441	(5,055,668,517)	(949,259,457)	6,807,791,467	86,660,394	6,468,839	93,129,233
2015	321,600,000,000	273,681,600,000	8,139,000,000	5,058,101,024	(5,357,972,287)	(959,303,627)	6,879,825,110	87,577,352	6,537,287	94,114,639
2016	315,880,000,000	268,813,880,000	8,139,000,000	5,454,014,055	(5,656,466,103)	(971,225,183)	6,965,322,769	88,665,702	6,618,527	95,284,230
2017	310,020,000,000	263,827,020,000	8,139,000,000	5,861,804,477	(5,966,574,495)	(983,178,899)	7,051,051,082	89,756,989	6,699,987	96,456,976
2018	304,280,000,000	258,942,280,000	9,000,000,000	6,946,364,111	(6,959,533,788)	(994,542,559)	7,992,287,764	101,738,546	7,494,390	109,232,935
2019	298,490,000,000	254,014,990,000	9,000,000,000	7,424,755,034	(7,333,620,029)	(1,006,085,610)	8,085,049,395	102,919,363	7,581,372	110,500,736
2020	293,130,000,000	249,453,630,000	9,000,000,000	7,917,497,685	(7,725,370,958)	(1,017,262,028)	8,174,864,700	104,062,675	7,665,592	111,728,268
2021	287,770,000,000	244,892,270,000	9,000,000,000	8,425,022,616	(8,120,889,434)	(1,029,657,409)	8,274,475,773	105,330,683	7,758,998	113,089,681
2022	282,630,000,000	240,518,130,000	9,000,000,000	8,947,773,294	(8,533,186,186)	(1,041,880,976)	8,372,706,132	106,581,116	7,851,109	114,432,224
2023	277,530,000,000	236,178,030,000	9,000,000,000	9,486,206,493	(8,955,781,226)	(1,054,700,399)	8,475,724,868	107,892,502	7,947,710	115,840,212
2024	272,800,000,000	232,152,800,000	9,000,000,000	10,040,792,688	(9,394,716,712)	(1,067,499,078)	8,578,576,898	109,201,766	8,044,154	117,245,920
2025	268,130,000,000	228,178,630,000	9,000,000,000	10,612,016,469	(9,839,205,210)	(1,081,524,449)	8,691,286,810	110,636,517	8,149,843	118,786,360
2026	263,580,000,000	224,306,580,000	9,000,000,000	11,200,376,963	(10,299,782,701)	(1,095,665,768)	8,804,928,493	112,083,129	8,256,405	120,339,534
2027	259,120,000,000	220,511,120,000	9,000,000,000	11,806,388,272	(10,774,761,912)	(1,110,166,654)	8,921,459,706	113,566,524	8,365,677	121,932,200
2028	254,770,000,000	216,809,270,000	9,000,000,000	12,430,579,920	(11,265,588,339)	(1,124,925,738)	9,040,065,842	115,076,331	8,476,894	123,553,225
2029	250,490,000,000	213,166,990,000	9,000,000,000	13,073,497,317	(11,771,909,843)	(1,140,042,351)	9,161,545,124	116,622,712	8,590,805	125,213,518
2030	246,280,000,000	209,584,280,000	9,000,000,000	13,735,702,237	(12,295,681,191)	(1,155,362,333)	9,284,658,714	118,189,898	8,706,249	126,896,147
2031	242,040,000,000	205,976,040,000	9,000,000,000	14,417,773,304	(12,837,409,971)	(1,170,893,546)	9,409,469,787	119,778,692	8,823,285	128,601,977
2032	237,930,000,000	202,478,430,000	9,000,000,000	15,120,306,503	(13,401,845,088)	(1,186,176,400)	9,532,285,015	121,342,079	8,938,449	130,280,528
2033	233,890,000,000	199,040,390,000	9,000,000,000	15,843,915,698	(13,982,929,910)	(1,201,949,098)	9,659,036,691	122,955,576	9,057,305	132,012,881
2034	229,870,000,000	195,619,370,000	9,000,000,000	16,589,233,169	(14,583,677,523)	(1,217,948,162)	9,787,607,485	124,592,230	9,177,866	133,770,095
2035	225,490,000,000	191,891,990,000	9,000,000,000	17,356,910,164	(15,206,961,110)	(1,233,927,699)	9,916,021,355	126,226,885	9,298,280	135,525,165
2036	221,530,000,000	188,522,030,000	9,000,000,000	18,147,617,469	(15,871,651,906)	(1,247,873,526)	10,028,092,037	127,653,499	9,403,369	137,056,868
2037	217,670,000,000	185,237,170,000	9,000,000,000	18,962,045,993	(16,541,946,722)	(1,263,824,323)	10,156,274,948	129,285,215	9,523,566	138,808,781
2038	213,950,000,000	182,071,450,000	9,000,000,000	19,800,907,373	(17,233,125,002)	(1,280,167,920)	10,287,614,452	130,957,113	9,646,724	140,603,837
2039	210,080,000,000	178,778,080,000	9,000,000,000	20,664,934,594	(17,943,604,504)	(1,297,160,534)	10,424,169,556	132,695,404	9,774,772	142,470,175
2040	206,330,000,000	175,586,830,000	9,000,000,000	21,554,882,632	(18,689,238,865)	(1,313,131,248)	10,552,512,519	134,329,157	9,895,119	144,224,276
2041	202,690,000,000	172,489,190,000	9,000,000,000	22,471,529,111	(19,456,840,462)	(1,329,625,548)	10,685,063,102	136,016,472	10,019,412	146,035,884
2042	198,980,000,000	169,331,980,000	9,000,000,000	23,415,674,984	(20,247,425,962)	(1,346,619,563)	10,821,629,460	137,754,905	10,147,471	147,902,376

* If the Series 2006-1 Bonds were paid according to their schedule of Sinking Fund Installments and Turbo Term Bond Maturities, the Applicable Percentage of Pledged TSRs would remain at 37.40% for the life of the transaction.

** Assumes 37.40% of TSASC's 3.4036337% share of payments, or 1.272959% of total annual payments under the MSA.

Debt Service Coverage

Set forth below is a schedule showing estimated debt service for the Series 2006-1 Bonds and the resulting estimated debt service coverage ratios, assuming the Series 2006-1 Bonds bear interest at the rates shown on the inside front cover hereof, cigarette consumption is consistent with the Global Insight Base Case Forecast, Collections are received in accordance with the Cash Flow Assumptions and no Turbo Redemptions are made in advance of the schedule of Sinking Fund Installments and Turbo Term Bond Maturities. Under such assumptions, no Turbo Redemptions are made and accordingly, the Applicable Percentage of Pledged TSRs remains constant at 37.40% for the life of the transaction. As used herein, "**debt service coverage ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period which includes earnings on the Liquidity Reserve Account and other Pledged Accounts and earnings on Pledged TSRs until the applicable Distribution Date and the denominator of which is the sum, for the Series 2006-1 Bonds, of interest, Sinking Fund Installments and Turbo Term Bond Maturities required to be paid in such period plus Operating Expenses at the Operating Cap. The denominator does not include Turbo Redemptions from Surplus Collections. Sinking Fund Installments are based on the assumption that no such Turbo Redemptions will occur. Under the Global Insight Base Case Forecast, the average debt service coverage ratio is 1.41x with a minimum debt service coverage ratio in 2009 through 2011 of 1.18x.

Estimated Debt Service Coverage Assuming the Applicable Percentage of Pledged TSRs is 37.40% in Every Year

Year	Total Available Funds[1]	Sinking Fund Installments And Turbo Term Bond Maturities	Interest	Operating Expenses[2]	Total Debt Service and Operating Expenses[3]	Debt Service Coverage for Series 2006-1 Bonds
2006	$84,770,923	$8,685,000	$54,864,796	$1,000,000	$64,549,796	1.31x
2007	88,239,716	2,755,000	67,186,138	1,030,000	70,971,138	1.24x
2008	91,053,201	5,085,000	66,999,938	1,060,900	73,145,838	1.24x
2009	92,213,649	10,680,000	66,625,519	1,092,727	78,398,246	1.18x
2010	93,217,164	12,035,000	66,086,038	1,125,509	79,246,546	1.18x
2011	94,325,063	13,555,000	65,478,275	1,159,274	80,192,549	1.18x
2012	95,424,444	13,060,000	64,846,169	1,194,052	79,100,221	1.21x
2013	96,462,562	13,305,000	64,220,000	1,229,874	78,754,874	1.22x
2014	97,475,393	15,760,000	63,529,706	1,266,770	80,556,476	1.21x
2015	98,448,941	15,295,000	62,792,150	1,304,773	79,391,923	1.24x
2016	99,614,295	16,965,000	62,025,975	1,343,916	80,334,891	1.24x
2017	100,781,990	18,715,000	61,178,575	1,384,234	81,277,809	1.24x
2018	113,567,748	25,130,000	60,137,256	1,425,761	86,693,017	1.31x
2019	114,823,175	26,295,000	58,915,913	1,468,534	86,679,446	1.32x
2020	116,037,506	27,440,000	57,639,706	1,512,590	86,592,296	1.34x
2021	117,386,276	28,965,000	56,300,088	1,557,967	86,823,055	1.35x
2022	118,714,685	30,345,000	54,891,475	1,604,706	86,841,181	1.37x
2023	120,107,237	31,880,000	53,373,781	1,652,848	86,906,629	1.38x
2024	121,496,630	33,510,000	51,739,031	1,702,433	86,951,464	1.40x
2025	123,020,146	35,290,000	50,019,031	1,753,506	87,062,537	1.41x
2026	124,555,227	37,085,000	48,209,656	1,806,111	87,100,767	1.43x
2027	126,128,756	38,935,000	46,309,156	1,860,295	87,104,451	1.45x
2028	127,729,971	40,960,000	44,311,781	1,916,103	87,187,885	1.46x
2029	129,369,490	43,110,000	42,210,031	1,973,587	87,293,618	1.48x
2030	131,030,076	45,320,000	39,999,281	2,032,794	87,352,075	1.50x
2031	132,712,380	47,540,000	37,677,781	2,093,778	87,311,559	1.52x
2032	134,365,274	49,580,000	35,249,781	2,156,591	86,986,373	1.54x
2033	136,072,880	52,300,000	32,702,781	2,221,289	87,224,070	1.56x
2034	137,803,093	54,905,000	30,022,656	2,287,928	87,215,584	1.58x
2035	139,530,055	57,960,000	27,164,806	2,356,566	87,481,372	1.59x
2036	141,031,503	61,055,000	24,115,047	2,427,262	87,597,309	1.61x
2037	142,751,054	64,170,000	20,906,156	2,500,080	87,576,237	1.63x
2038	144,512,201	67,475,000	17,532,753	2,575,083	87,582,836	1.65x
2039	146,343,036	70,995,000	13,984,459	2,652,335	87,631,795	1.67x
2040	148,061,342	75,160,000	10,239,238	2,731,905	88,131,143	1.68x
2041	149,833,248	79,035,000	6,287,991	2,813,862	88,136,853	1.70x
2042	149,950,227	83,175,000	2,131,359	2,898,278	88,204,638	1.70x

(1) Includes Pledged TSRs plus earnings on the Liquidity Reserve Account and other Pledged Accounts until distributed.
(2) Includes Operating Expenses at the Operating Cap.
(3) Includes interest, Sinking Fund Installments and Turbo Term Bond Maturities on the Series 2006-1 Bonds and Operating Expenses at the Operating Cap.

The estimated debt service coverage ratios shown in the preceding table assume that Collections are received in accordance with the Cash Flow Assumptions and applied, subject to the payment priorities set forth in the Indenture, to pay expenses, interest as due, Sinking Fund Installments and Turbo Term Bond Maturities for the Series 2006-1 Bonds. The above table does not reflect the actual amortization of Series 2006-1 Bonds which will occur if the Global Insight Base Case Forecast is realized. If actual Collections are received in the amounts assumed under the Global Insight Base Case Forecast and the

Cash Flow Assumptions, Surplus Collections would be applied to make Turbo Redemptions, as required pursuant to the Indenture and the Applicable Percentage of Pledged TSRs would decline. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION – Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions" herein.

Allocation of Principal Payments

Due to a number of factors, including the actual consumption of cigarettes in the United States, the amount of Collections will fluctuate from year to year. Unless an Event of Default has occurred, Collections available to make principal payments on the Series 2006-1 Bonds on any Distribution Date will be allocated to Sinking Fund Installments and Turbo Term Bond Maturities due prior to allocations to Turbo Redemptions. Surplus Collections available to make Turbo Redemptions will be credited against Sinking Fund Installments and Turbo Term Bond Maturities in chronological order.

Effect of Changes in Cigarette Consumption Levels on the Applicable Percentage of Pledged TSRs and Turbo Redemptions

Applicable Percentage of Pledged TSRs. The table below has been prepared to show the effect of changes in cigarette consumption on the Applicable Percentage of Pledged TSRs. The table is based on the Cash Flow Assumptions and the Bond Structuring Methodology, except that the annual cigarette consumption varies in each case. In addition to the Global Insight Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of Global Insight (the Global Insight High Forecast, the Global Insight Low Case 1, the Global Insight Low Case 2 and the Global Insight Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by Global Insight (assuming 3.5% and 4.0% annual consumption declines). In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the Applicable Percentage of Pledged TSRs will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast.

Projections of the Applicable Percentage of Pledged TSRs

Applicable Percentage Effective Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Through June 1, 2024	37.40%	37.40%	37.40%	37.40%	37.40%	37.40%	37.40%
June 2, 2024	30.10%	30.10%	37.40%	37.40%	37.40%	37.40%	37.40%
June 2, 2025	18.68%	18.68%	37.40%	37.40%	37.40%	37.40%	37.40%
June 2, 2026	18.68%	18.68%	18.68%	37.40%	37.40%	37.40%	37.40%
June 2, 2027	18.68%	18.68%	18.68%	37.40%	37.40%	37.40%	37.40%
June 2, 2028	18.68%	18.68%	18.68%	18.68%	37.40%	37.40%	37.40%
June 2, 2029	4.25%		4.25%	4.25%	37.40%	37.40%	37.40%
June 2, 2030	4.25%		4.25%	4.25%	37.40%	37.40%	37.40%
June 2, 2031	4.25%		4.25%	4.25%	37.40%	37.40%	37.40%
June 2, 2032	4.25%		4.25%	4.25%	37.40%	37.40%	37.40%
June 2, 2033					37.40%	37.40%	37.40%
June 2, 2034						37.40%	37.40%
June 2, 2035						37.40%	37.40%
June 2, 2036							37.40%
June 2, 2037							37.40%
June 2, 2038							37.40%
June 2, 2039							37.40%
June 2, 2040							37.40%
June 2, 2041							

Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in cigarette consumption on the weighted average lives and final principal payments of the Series 2006-1 Bonds. The tables are based on the Cash Flow Assumptions and the Bond Structuring Methodology, except that the annual cigarette consumption varies in each case. The tables are based on the same assumptions and utilize the same alternative Global Insight forecasts as shown in the preceding paragraph and table. In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the final principal payments and weighted average lives (in years) of each of the Series 2006-1 Bonds will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast. To the degree actual consumption varies from the alternative scenarios presented below or other Cash Flow Assumptions are not realized, the weighted average lives (and final principal payment dates) for the Series 2006-1 Bonds will be either shorter (sooner) or longer (later) than projected below.

Series 2006-1 Bonds Maturing June 1, 2022

Consumption Forecast	Expected Weighted Average Life (Years)	Final Principal Payment Date (June 1)
Global Insight Base Case Forecast	4.8 years	June 1, 2015
Global Insight High Forecast	4.7 years	June 1, 2014
Global Insight Low Case 1	4.9 years	June 1, 2015
Global Insight Low Case 2	5.1 years	June 1, 2015
Global Insight Low Case 3	8.3 years	June 1, 2020
3.5% Annual Consumption Decline	6.0 years	June 1, 2018
4.0% Annual Consumption Decline	6.7 years	June 1, 2019

Series 2006-1 Bonds Maturing June 1, 2026

Consumption Forecast	Expected Weighted Average Life (Years)	Final Principal Payment Date (June 1)
Global Insight Base Case Forecast	10.4 years	June 1, 2017
Global Insight High Forecast	10.2 years	June 1, 2017
Global Insight Low Case 1	10.7 years	June 1, 2018
Global Insight Low Case 2	11.1 years	June 1, 2018
Global Insight Low Case 3	15.7 years	June 1, 2023
3.5% Annual Consumption Decline	13.7 years	June 1, 2021
4.0% Annual Consumption Decline	15.3 years	June 1, 2023

Series 2006-1 Bonds Maturing June 1, 2034

Consumption Forecast	Expected Weighted Average Life (Years)	Final Principal Payment Date (June 1)
Global Insight Base Case Forecast	14.4 years	June 1, 2022
Global Insight High Forecast	14.1 years	June 1, 2022
Global Insight Low Case 1	14.8 years	June 1, 2023
Global Insight Low Case 2	15.4 years	June 1, 2024
Global Insight Low Case 3	20.3 years	June 1, 2029
3.5% Annual Consumption Decline	19.3 years	June 1, 2029
4.0% Annual Consumption Decline	22.4 years	June 1, 2033

Series 2006-1 Bonds Maturing June 1, 2042

Consumption Forecast	Expected Weighted Average Life (Years)	Final Principal Payment Date (June 1)
Global Insight Base Case Forecast	20.4 years	June 1, 2033
Global Insight High Forecast	19.6 years	June 1, 2029
Global Insight Low Case 1	20.7 years	June 1, 2033
Global Insight Low Case 2	21.1 years	June 1, 2033
Global Insight Low Case 3	26.2 years	June 1, 2034
3.5% Annual Consumption Decline	27.2 years	June 1, 2036
4.0% Annual Consumption Decline	32.1 years	June 1, 2041

Turbo Redemptions. The tables below have been prepared to show the effect of changes in cigarette consumption on the projected outstanding amounts of the Series 2006-1 Bonds. The tables are based upon the same assumptions and utilize the same alternative Global Insight forecasts as shown in the preceding paragraph and tables.

Projected Outstanding Principal Balances for Series 2006-1 Bonds Maturing June 1, 2022*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Feb. 8, 2006	284,070,000	284,070,000	284,070,000	284,070,000	284,070,000	284,070,000	284,070,000
June 1, 2006	254,605,000	254,460,000	254,755,000	254,930,000	254,605,000	255,860,000	256,280,000
June 1, 2007	233,105,000	232,660,000	233,600,000	234,185,000	243,890,000	237,225,000	238,500,000
June 1, 2008	207,715,000	206,805,000	208,805,000	210,070,000	234,790,000	216,505,000	219,110,000
June 1, 2009	179,955,000	178,460,000	181,935,000	184,160,000	224,305,000	195,235,000	199,645,000
June 1, 2010	149,860,000	147,605,000	153,030,000	156,540,000	212,490,000	173,390,000	180,085,000
June 1, 2011	117,210,000	114,015,000	121,855,000	126,955,000	199,190,000	150,930,000	160,420,000
June 1, 2012	81,880,000	77,540,000	88,295,000	95,310,000	184,340,000	127,825,000	140,630,000
June 1, 2013	43,810,000	38,120,000	52,310,000	61,570,000	167,915,000	104,040,000	120,700,000
June 1, 2014	2,905,000	-	13,820,000	25,670,000	149,870,000	79,535,000	100,610,000
June 1, 2015	-	-	-	-	130,150,000	54,275,000	80,340,000
June 1, 2016	-	-	-	-	108,515,000	28,215,000	59,875,000
June 1, 2017	-	-	-	-	84,880,000	1,315,000	39,190,000
June 1, 2018	-	-	-	-	49,315,000	-	9,220,000
June 1, 2019	-	-	-	-	10,990,000	-	-
June 1, 2020	-	-	-	-	-	-	-
June 1, 2021	-	-	-	-	-	-	-
June 1, 2022	-	-	-	-	-	-	-
Average Life	4.8 years	4.7 years	4.9 years	5.1 years	8.3 years	6.0 years	6.7 years
Projected Maturity	June 1, 2015	June 1, 2014	June 1, 2015	June 1, 2015	June 1, 2020	June 1, 2018	June 1, 2019

* Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Surplus Collections to Turbo Redemptions on the referenced date.

Projected Outstanding Principal Balances for Series 2006-1 Bonds Maturing June 1, 2026*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Feb. 8, 2006	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2006	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2007	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2008	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2009	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2010	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2011	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2012	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2013	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2014	137,765,000	133,400,000	137,765,000	137,765,000	137,765,000	137,765,000	137,765,000
June 1, 2015	96,770,000	87,665,000	110,490,000	125,345,000	137,765,000	137,765,000	137,765,000
June 1, 2016	49,480,000	38,285,000	66,355,000	84,595,000	137,765,000	137,765,000	137,765,000
June 1, 2017	-	-	19,045,000	41,090,000	137,765,000	137,765,000	137,765,000
June 1, 2018	-	-	-	-	137,765,000	101,600,000	137,765,000
June 1, 2019	-	-	-	-	137,765,000	62,665,000	116,370,000
June 1, 2020	-	-	-	-	107,540,000	22,200,000	85,035,000
June 1, 2021	-	-	-	-	63,125,000	-	52,910,000
June 1, 2022	-	-	-	-	15,350,000	-	19,950,000
June 1, 2023	-	-	-	-	-	-	-
June 1, 2024	-	-	-	-	-	-	-
June 1, 2025	-	-	-	-	-	-	-
June 1, 2026	-	-	-	-	-	-	-
Average Life	10.4 years	10.2 years	10.7 years	11.1 years	15.7 years	13.7 years	15.3 years
Projected Maturity	June 1, 2017	June 1, 2017	June 1, 2018	June 1, 2018	June 1, 2023	June 1, 2021	June 1, 2023

* Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Surplus Collections to Turbo Redemptions on the referenced date.

Projected Outstanding Principal Balances for Series 2006-1 Bonds Maturing June 1, 2034*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Feb. 8, 2006	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2006	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2007	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2008	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2009	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2010	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2011	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2012	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2013	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2014	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2015	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2016	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2017	371,275,000	357,715,000	372,650,000	372,650,000	372,650,000	372,650,000	372,650,000
June 1, 2018	304,735,000	288,265,000	329,455,000	356,105,000	372,650,000	372,650,000	372,650,000
June 1, 2019	233,555,000	213,825,000	263,050,000	294,815,000	372,650,000	372,650,000	372,650,000
June 1, 2020	157,545,000	134,190,000	192,320,000	229,730,000	372,650,000	372,650,000	372,650,000
June 1, 2021	76,320,000	48,955,000	116,890,000	160,460,000	372,650,000	352,765,000	372,650,000
June 1, 2022	-	-	36,560,000	86,880,000	372,650,000	308,970,000	372,650,000
June 1, 2023	-	-	-	8,645,000	336,640,000	263,380,000	358,750,000
June 1, 2024	-	-	-	-	281,515,000	215,895,000	323,950,000
June 1, 2025	-	-	-	-	222,325,000	166,415,000	288,135,000
June 1, 2026	-	-	-	-	158,850,000	114,835,000	251,250,000
June 1, 2027	-	-	-	-	90,840,000	61,040,000	213,225,000
June 1, 2028	-	-	-	-	18,045,000	4,910,000	173,990,000
June 1, 2029	-	-	-	-	-	-	133,470,000
June 1, 2030	-	-	-	-	-	-	91,585,000
June 1, 2031	-	-	-	-	-	-	48,260,000
June 1, 2032	-	-	-	-	-	-	3,410,000
June 1, 2033	-	-	-	-	-	-	-
June 1, 2034	-	-	-	-	-	-	-
Average Life	14.4 years	14.1 years	14.8 years	15.4 years	20.3 years	19.3 years	22.4 years
Projected Maturity	June 1, 2022	June 1, 2022	June 1, 2023	June 1, 2024	June 1, 2029	June 1, 2029	June 1, 2033

* Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Surplus Collections to Turbo Redemptions on the referenced date.

Projected Outstanding Principal Balances for Series 2006-1 Bonds Maturing June 1, 2042*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Feb. 8, 2006	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2006	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2007	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2008	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2009	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2010	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2011	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2012	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2013	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2014	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2015	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2016	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2017	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2018	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2019	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2020	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2021	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2022	548,660,000	516,845,000	559,025,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2023	456,110,000	419,370,000	509,980,000	559,025,000	559,025,000	559,025,000	559,025,000
June 1, 2024	357,345,000	315,195,000	418,815,000	484,575,000	559,025,000	559,025,000	559,025,000
June 1, 2025	275,785,000	228,430,000	321,610,000	396,120,000	559,025,000	559,025,000	559,025,000
June 1, 2026	226,585,000	174,775,000	218,045,000	302,015,000	559,025,000	559,025,000	559,025,000
June 1, 2027	174,060,000	117,440,000	167,845,000	201,945,000	559,025,000	559,025,000	559,025,000
June 1, 2028	118,025,000	56,220,000	114,385,000	95,580,000	559,025,000	559,025,000	559,025,000
June 1, 2029	58,280,000	-	57,475,000	40,875,000	499,170,000	505,310,000	559,025,000
June 1, 2030	45,045,000	-	44,915,000	28,205,000	415,845,000	444,025,000	559,025,000
June 1, 2031	30,980,000	-	31,600,000	14,810,000	326,780,000	379,930,000	559,025,000
June 1, 2032	16,055,000	-	17,490,000	645,000	231,695,000	312,870,000	559,025,000
June 1, 2033	-	-	-	-	130,235,000	242,685,000	515,940,000
June 1, 2034	-	-	-	-	-	169,205,000	467,670,000
June 1, 2035	-	-	-	-	-	92,255,000	417,520,000
June 1, 2036	-	-	-	-	-	-	365,385,000
June 1, 2037	-	-	-	-	-	-	311,150,000
June 1, 2038	-	-	-	-	-	-	254,690,000
June 1, 2039	-	-	-	-	-	-	195,875,000
June 1, 2040	-	-	-	-	-	-	134,575,000
June 1, 2041	-	-	-	-	-	-	-
June 1, 2042	-	-	-	-	-	-	-
Average Life	20.4 years	19.6 years	20.7 years	21.1 years	26.2 years	27.2 years	32.1 years
Projected Maturity	June 1, 2033	June 1, 2029	June 1, 2033	June 1, 2033	June 1, 2034	June 1, 2036	June 1, 2041

* Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Surplus Collections to Turbo Redemptions on the referenced date.

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Explanation of Alternative Global Insight Forecasts

The alternative Global Insight forecasts of cigarette consumption decline, used in the analysis above, are based upon the assumptions described below. See also "TOBACCO CONSUMPTION REPORT" herein and Appendix A hereto.

Global Insight's high forecast of consumption (the "**Global Insight High Forecast**") deviates from the Base Case Forecast by using a lower price forecast, under which prices are increasing at an annual rate of 0.5% more slowly than the Global Insight Base Case Forecast. Under the Global Insight High Forecast, the average annual rate of decline in cigarette consumption is reduced slightly, from an average annual rate in the Base Case Forecast of 1.78%, to 1.62%, resulting in consumption of 211 billion in 2042.

Global Insight's low forecast of consumption (the "**Global Insight Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The Global Insight Base Case Forecast applies a price elasticity of demand of -0.33. However, in order to develop the lowest consumption forecast that Global Insight believes may be reasonably anticipated, a price elasticity of -0.4 is applied. Under the Global Insight Low Case 1 Forecast, the average annual rate of decline in cigarette consumption is increased from an average annual rate in the Base Case Forecast of 1.78%, to 1.96%, resulting in consumption of 185 billion in 2042.

Although beyond the range of Global Insight's reasonably anticipated decline in consumption, Global Insight also prepared an alternative low case (the "**Global Insight Low Case 2**") that deviates from the Base Case Forecast by assuming a price elasticity of demand of -0.5. This produces a decline in consumption of an average annual rate of 2.17% to 171 billion in 2042. Global Insight prepared another alternative low case (the "**Global Insight Low Case 3**") that deviates from the Base Case Forecast by assuming an adverse federal government settlement or tort claims of three times the size of the MSA, resulting in an immediate real price increase of 57% and a decline of 18% in consumption over two years. Under the Global Insight Low Case 3, the average annual rate of decline in cigarette consumption is increased from an average annual rate in the Base Case Forecast of 1.78%, to 2.29%, resulting in consumption of 163 billion in 2042.

Average Annual Rate of Cigarette Consumption Decline (2004-2042)

Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3
1.78%	1.62%	1.96%	2.17%	2.29%

Finally, for comparative purposes Global Insight calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4.0%. Global Insight states that at 3.5% per year consumption falls to 101 billion by 2042, and at 4.0% it falls to 83 billion.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2006-1 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Cash Flow Assumptions, the Applicable Percentage of Pledged TSRs and the amount of Surplus Collections available to make Turbo Redemptions will be affected and the resulting weighted average lives and final principal payment dates of the Series 2006-1 Bonds will vary. See "RISK FACTORS" herein.

TSASC, INC.

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
Mark Page	Director of Management and Budget of the City
Martha E. Stark	Commissioner of Finance of the City
William C. Thompson	Comptroller of the City
Christine Quinn	Speaker of the City Council
Michael A. Cardozo	Corporation Counsel of the City

The officers of TSASC are:

Name	Office
Mark Page	President
Alan L. Anders	Vice President and Treasurer
Marjorie E. Henning	Vice President and Secretary
Prescott D. Ulrey	Assistant Secretary
Lawrence R. Glantz	Comptroller
F. Jay Olson	Deputy Treasurer
Philip Wasserman	Assistant Treasurer
Michele Mark Levine	Assistant Comptroller

Mark Page, President

Mr. Page was appointed President in November 1999. Mr. Page also serves as the Director of Management and Budget of the City. Mr. Page has worked for the City since 1978. Mr. Page is a graduate of Harvard University and New York University School of Law.

Alan L. Anders, Vice President and Treasurer

Mr. Anders was appointed Vice President and Treasurer in November 1999. 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.

Marjorie E. Henning, Vice President and Secretary

Ms. Henning was appointed Vice President and Secretary in November 1999. Ms. Henning also serves as General Counsel to the Office of Management and Budget of the City. Ms. Henning is a graduate of the State University of New York at Buffalo and the Harvard Law School.

Prescott D. Ulrey, Assistant Secretary

Mr. Ulrey was appointed Assistant Secretary in November 1999. 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. He also serves as Counsel to the Office of Management and Budget of the City.

Lawrence R. Glantz, Comptroller

Mr. Glantz was appointed Comptroller in November 1999. He is a graduate of Hofstra University.

F. Jay Olson, Deputy Treasurer

Mr. Olson was appointed Deputy Treasurer in December 2004. He is a graduate of Northwestern University, the University of Texas at Austin, and the John F. Kennedy School of Government at Harvard University. He is a certified treasury professional.

Philip Wasserman, Assistant Treasurer

Mr. Wasserman was appointed Assistant Treasurer in December 2004. He is a graduate of Cornell University, Columbia University, and the University of Texas at Austin.

Michele Mark Levine, Assistant Comptroller

Ms. Levine was appointed Assistant Comptroller in December 2004. She is a graduate of the State University of New York at Binghamton and the Maxwell School of Citizenship and Public Administration at Syracuse University.

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

To the extent that Rule 15c2-12 (the "**Rule**") of the Securities and Exchange Commission (the "**SEC**") promulgated under the Securities Exchange Act of 1934, as amended (the "**1934 Act**"), requires the Underwriters to determine, as a condition to purchasing the Series 2006-1 Bonds, that TSASC will make such covenants, TSASC will covenant for the sole benefit of the Bondholders as follows:

TSASC shall provide:

(a) within nine calendar months after the end of each Fiscal Year, to each nationally recognized municipal securities information repository and to any state information depository for the State, (1) core financial information and operating data for the prior fiscal year, including its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (2) an update of operating data for such preceding Fiscal Year set forth under the column titled "Annual Payments to TSASC" in the table captioned "Projection of Annual Payments to be Received by TSASC" in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION—Debt Service Coverage" herein and (3) the actual debt service coverage ratio for such preceding Fiscal Year, determined in substantially the manner described in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION—Debt Service Coverage" herein; and

(b) in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any New York State information depository, notice of any of the following events with respect to the Bonds, if material:

(1) principal and interest payment delinquencies;

(2) non-payment related defaults;

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

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

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

(6) adverse tax opinions or events affecting the tax-exempt status of the Bonds;

(7) modifications to rights of Bondholders;

(8) bond calls;

(9) defeasances;

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

(11) rating changes; and

(12) failure of TSASC to comply with clause (a) above.

Any filing in accordance with (a) or (b) above may be made solely by transmitting such filing to the Texas Municipal Advisory Council (the "**MAC**") as provided at www.DisclosureUSA.org unless the

Securities and Exchange Commission has withdrawn the interpretive advise in its letter to the MAC dated September 7, 2004.

TSASC will not undertake to provide any notice with respect to (i) credit enhancement if the credit enhancement is added after the primary offering of the Series 2006-1 Bonds, TSASC does not apply for or participate in obtaining the enhancement and the enhancement is not described in this Offering Circular or (ii) tax exemption other than pursuant to Section 103 of the Code.

TSASC will not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if (i) the terms, dates and amounts of redemption are set forth in detail herein, (ii) the only open issue is which Series 2006-1 Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Bondholders as required under the terms of the Series 2006-1 Bonds and (iv) public notice of the redemption is given pursuant to 1934 Act Release No. 23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Series 2006-1 Bond purchases.

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

No Bondholder may institute any suit, action or proceeding at law or in equity ("**Proceeding**") for the enforcement of the continuing disclosure undertaking (the "**Undertaking**") or for any remedy for breach thereof, unless such Bondholder shall have filed with TSASC evidence of ownership and a written notice of and request to cure such breach, and TSASC shall have refused to comply within a reasonable time. 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.

An amendment to the 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 TSASC, or type of business conducted; the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of a series of Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Bondholders, as determined by parties unaffiliated with TSASC (such as, but without limitation, TSASC'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 of the Series 2006-1 Bonds, ceases to be in effect for any reason, and TSASC elects that the Undertaking shall be deemed terminated or amended (as the case may be) accordingly.

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

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP ("**Transaction Counsel**"), under existing statutes and court decisions, and assuming, among other matters, continuing compliance with certain representations and compliance with certain covenants, interest on the Series 2006-1 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "**Code**"). Transaction Counsel is of the further opinion that interest on the Series 2006-1 Bonds is 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 is also of the opinion that, under existing statutes, the interest on the Series 2006-1 Bonds is excluded from New York adjusted gross income for purposes of personal income taxes imposed by the State and any political subdivision thereof (including the City), to the extent that such interest is excluded from gross income for federal income tax purposes. A complete copy of the proposed form of opinion of Transaction Counsel is set forth in APPENDIX E hereto.

To the extent the issue price of the Series 2006-1 Bonds is less than the amount to be paid at maturity of the Series 2006-1 Bonds (excluding amounts stated to be interest and payable at least annually over the term of the Series 2006-1 Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Bondholder thereof, is treated as interest on the Series 2006-1 Bonds which is excluded from gross income for federal income tax purposes. For this purpose, the issue price of the Series 2006-1 Bonds is the first price at which a substantial amount of the Series 2006-1 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 the Series 2006-1 Bonds accrues daily over the term to maturity of the Series 2006-1 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 the Series 2006-1 Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of the Series 2006-1 Bonds. Bondholders of the Series 2006-1 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series 2006-1 Bonds with original issue discount, including the treatment of Bondholders who do not purchase such Series 2006-1 Bonds in the original offering to the public at the first price at which a substantial amount of such Series 2006-1 Bonds are sold to the public.

Series 2006-1 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 2006-1 Bonds. 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 2006-1 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 2006-1 Bonds being included in gross income for federal, State and local income tax purposes, possibly from the date of original issuance of the Series 2006-1 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 2006-1 Bonds may adversely affect the value of, or the tax status of interest on, the Series 2006-1 Bonds.

Certain requirements and procedures contained or referred to in the Indenture, the Tax Certificates executed by TSASC and the City and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Series 2006-1 Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Transaction Counsel expresses no opinion as to any Series 2006-1 Bonds or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than Orrick, Herrington & Sutcliffe LLP.

Although Transaction Counsel is of the opinion that interest on the Series 2006-1 Bonds is excluded from gross income for federal income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006-1 Bonds may otherwise affect a Bondholder's federal, state or local tax liability. The nature and extent of these other tax consequences depend upon the particular tax status of the Bondholder or the Bondholder's other items of income or deduction. Transaction Counsel expresses no opinion regarding any such other tax consequences.

Future legislation, if enacted into law, or clarification of the Code may cause interest on the Series 2006-1 Bonds to be subject, directly or indirectly, to federal income taxation, or otherwise prevent Bondholders from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislation or clarification of the Code may also affect the market price for, or marketability of, the Series 2006-1 Bonds. Prospective purchasers of the Series 2006-1 Bonds should consult their own tax advisers regarding any pending or proposed federal tax legislation, as to which Transaction Counsel expresses 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 2006-1 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 2006-1 Bonds ends with the sale of the Series 2006-1 Bonds and, unless separately engaged, Transaction Counsel is not obligated to defend TSASC, the City or the Bondholders regarding the tax-exempt status of the Series 2006-1 Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than TSASC or the City and their appointed counsel, including the Bondholders, 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 2006-1 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 2006-1 Bonds, and may cause TSASC, the City or the Bondholders to incur significant expense.

LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2006-1 Bonds or questioning the creation, organization or existence of TSASC, the validity or enforceability of the Indenture, the sale of the TSRs by the City to TSASC, the proceedings for the authorization, execution, authentication and delivery of the Series 2006-1 Bonds or the validity of the Series 2006-1 Bonds.

RATINGS

It is a condition to the obligation of the Underwriters to purchase the Series 2006-1 Bonds that, at the date of delivery thereof to the Underwriters, the Series 2006-1 Bonds be assigned a rating of "BBB" by Fitch Ratings ("**Fitch**") and a rating of "BBB" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**S&P**" and, collectively with Fitch, the "**Rating Agencies**").

The Turbo Term Bond Maturities for the Series 2006-1 Bonds were structured to produce cash flow stress test performance necessary for TSASC to achieve the targeted credit ratings. The ratings address each Rating Agency's assessment of (i) the payment of interest on the Series 2006-1 Bonds when due, and (ii) the payment of principal of Series 2006-1 Bonds by their Maturity Dates. The ratings will not address the payment of Sinking Fund Installments or Turbo Redemptions on Series 2006-1 Bonds. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time.

The ratings by Fitch and S&P of the Series 2006-1 Bonds reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agencies with respect thereto should be obtained from the Rating Agency furnishing the same, at the following addresses: Fitch Ratings, One State Street Plaza, New York, New York 10004; Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., 55 Water Street, New York, New York 10004.

There is no assurance that the initial ratings assigned to the Series 2006-1 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by any of the Rating Agencies. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the availability of a market for or the market price of the Series 2006-1 Bonds.

S&P currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the Series 2006-1 Bonds, have a Negative Outlook. Fitch's view of the tobacco industry is a key factor in its ratings of tobacco settlement securitizations. Currently, Fitch indicates its outlook on the unsecured credit profile of the tobacco industry is negative.

UNDERWRITING

The underwriters listed on the cover page hereof (the "**Underwriters**") have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2006-1 Bonds from TSASC at an underwriters' discount of $9,999,128.83. The Underwriters will be obligated to purchase all of the Series 2006-1 Bonds if any are purchased. The initial public offering prices of the Series 2006-1 Bonds may be changed from time to time by the Underwriters.

Bear, Stearns & Co. Inc. is acting as representative on behalf of the Underwriters.

The Series 2006-1 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2006-1 Bonds into investment trusts) at prices lower than such public offering prices.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2006-1 Bonds, the arithmetical accuracy of certain computations included in the schedules provided by the Underwriters on behalf of TSASC relating to the: (i) adequacy of forecasted receipts of principal and interest on the Defeasance Collateral and cash to be held pursuant to the Refunding Escrow Agreement; (ii) forecasted payments of principal and interest with respect to the Refunded Bonds on and prior to their projected maturities and/or redemption dates; and (iii) yields with respect to the Series 2006-1 Bonds and on the obligations and other securities to be deposited pursuant to the Refunding Escrow Agreement upon delivery of the Series 2006-1 Bonds, 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.

LEGAL MATTERS

Orrick, Herrington & Sutcliffe LLP, New York, New York, Transaction Counsel, will render its opinion with respect to the validity of the Series 2006-1 Bonds in substantially the form set forth in Appendix E hereto.

Certain legal matters with respect to the City will be passed upon by its Corporation Counsel. Certain legal matters with respect to TSASC will be passed upon by Orrick, Herrington & Sutcliffe LLP, New York, New York, as Transaction Counsel.

Certain legal matters will be passed upon for the Underwriters by Sidley Austin LLP, New York, New York, as Underwriters' Counsel.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The financial statements of TSASC as of and for the years ended June 30, 2005 and 2004, included in this Offering Circular have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report appearing in Appendix D hereto.

OTHER PARTIES

Financial Advisor

First Southwest Company is employed as financial advisor to TSASC in connection with the issuance of the Series 2006-1 Bonds. The financial advisor's fee for services rendered with respect to the sale of the Series 2006-1 Bonds is not contingent upon the issuance and delivery of the Series 2006-1 Bonds. First Southwest Company, in its capacity as financial advisor, does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Series 2006-1 Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

The financial advisor to TSASC has provided the following sentence for inclusion in this Offering Circular. The financial advisor has reviewed the information in this Offering Circular in accordance with, and as part of, its responsibilities to TSASC and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the financial advisor does not guarantee the accuracy or completeness of such information.

Global Insight

Global Insight has been retained on behalf of TSASC as an independent econometric consultant. The Global Insight Consumption Report attached as Appendix A hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as TSASC's independent economic consultant are not contingent upon the issuance of the Series 2006-1 Bonds. The Global Insight Consumption Report should be read in its entirety before purchasing any Series 2006-1 Bonds.

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APPENDIX A

GLOBAL INSIGHT CONSUMPTION REPORT

A Forecast of U.S. Cigarette Consumption (2004-2042) for TSASC, Inc.

Submitted to:

TSASC, Inc.

Prepared by:

Global Insight, Inc.

February 3, 2006

Global Insight

Jim Diffley
Group Managing Director

Jeannine Cataldi
Senior Economist

Global Insight, Inc.
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Eddystone, PA 19022

(610) 490-2642

Executive Summary

Global Insight[1] has developed a cigarette consumption model based on historical U.S. data between 1965 and 2003. This econometric model, coupled with our long term forecast of the U.S. economy, has been used to project total U.S. cigarette consumption from 2004 through 2042. Our Base Case Forecast indicates that total consumption in 2042 will be 199 billion cigarettes (approximately 10 billion packs), a 50% decline from the 2003 level. From 2004 through 2042 the average annual rate of decline is projected to be 1.78%. On a per capita basis consumption is projected to fall at an average rate of 2.55% per year. We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2042 U.S. cigarette consumption could be as low as 185 billion and as high as 211 billion cigarettes. In addition, we also present scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

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

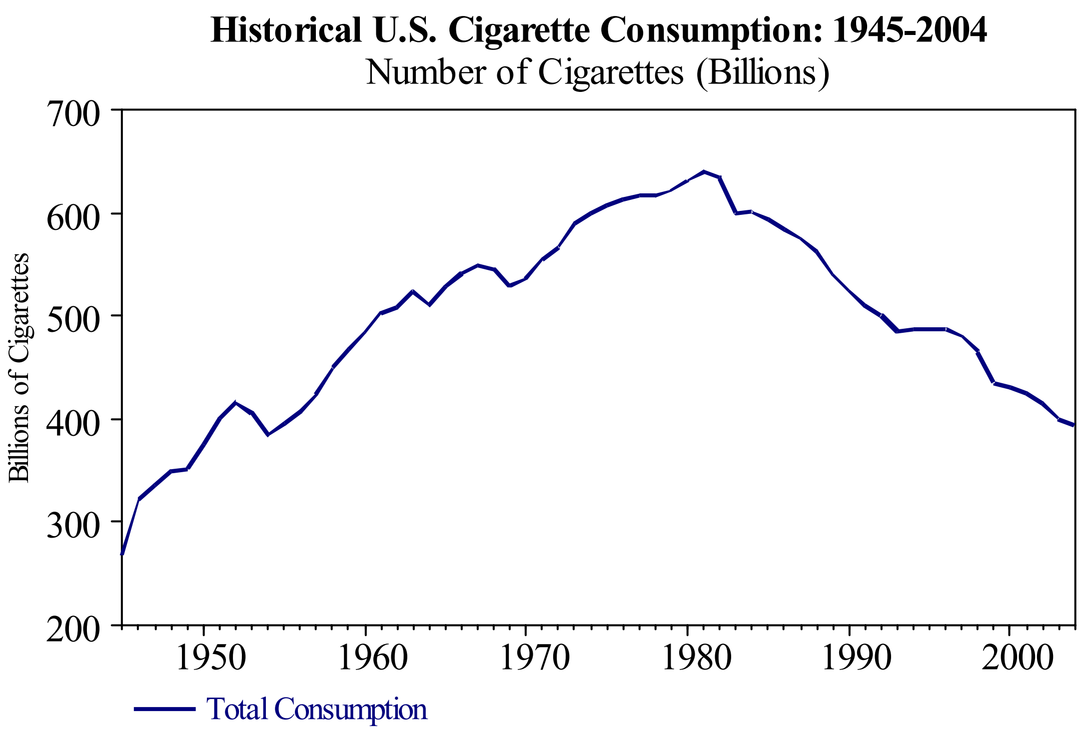
[1] On November 4, 2002, **DRI•WEFA** was re-named **Global Insight**.

Disclaimer

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

Historical Cigarette Consumption

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[2]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[3] as reported by the Bureau of Alcohol Tobacco and Firearms. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion in 1900 to a peak of 640 billion in 1981[4]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004[5].



While the historical trend in consumption prior to 1981 was increasing, there was a decline in cigarette consumption of 9.82% during the Great Depression between 1931 and 1932. Notwithstanding this steep decline, consumption rapidly increased after 1932,

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[2] *Source*: "Tobacco Timeline," Gene Borio (1998).
[3] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.
[4] *Source*: "Tobacco Situation and Outlook". U.S. Department of Agriculture-Economic Research Service. September 1999 (USDA-ERS).
[5] *Source*: USDA-ERS. April 2005.

and exceeded previous levels by 1934. Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.20% between 1965 and 1981. Between 1981 and 1990, however, cigarette consumption declined at an average annual rate of 2.18%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.51%; but for 1998 the decline increased to 3.13% and increased further to 6.45% for 1999. These recent declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA"). In 2000 and 2001, the rate of decline moderated, to 1.15% and 1.16%, respectively. More recently, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2004 to an annual rate of 2.58%.

Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) began to decline following the Surgeon General's Report in 1964. Population growth offset this decline until 1981. The adult population grew at an average annual rate of 1.86% for the period 1965 through 1981, 1.17% from 1981 to 1990 and 1.02% from 1990 to 1999. Adult per capita cigarette consumption declined at an average annual rate of 0.65% for the period 1965 to 1981, 3.31% for the period 1981 to 1990 and 2.47% for the period 1990 to 1998. In 1998 the per capita decline in cigarette consumption was 4.21% and in 1999 the decline accelerated to 7.50%. These sharp declines are correlated with large price increases in 1998 and 1999 following the MSA. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the seven years ended December 31, 2004[6]. The data in this table vary from statistics on cigarette shipments in the United States. While our Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change
2004	393est	-1.75
2003	400	-3.61
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

[6] *Source:* USDA-ERS; 2004 estimate by Global Insight.

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to reports of the manufacturers, the three leading manufacturers accounted for over 85% of U.S. shipments in 2004. These top companies were Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. Philip Morris and Reynolds American commanded 47.4% and 28.8%, respectively of the domestic market in 2004. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the Master Settlement Agreement.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue have fallen from 3.4% in 1950 to approximately 0.42% today. In 2004, the federal government received $7.9 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $12.6 billion in 2004, from excise and sales taxes. Cigarettes constitute the majority of these sales, which include cigars and other tobacco products. U.S. consumers spent $86.7 billion on tobacco products in 2003.[7]

Survey of the Economic Literature on Smoking

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

Incidence of Smoking

Approximately 44.5 million American adults were current smokers in 2004, representing approximately 20.9% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[8] released November 11, 2005. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in

[7] Ibid.
[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Cigarette Smoking Among Adults – United States, 2004". November 11, 2005.

1965 to 25.5% in 1990,[9] the incidence rate declined relatively slowly through the following decade. The decline has accelerated since 2002, when the incidence rate was 22.5%.

Youth Smoking

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

In 2004, the CDC's National Youth Tobacco Survey, formerly done by the American Legacy Foundation, reported that the percentage of middle school students who were current users of cigarettes declined from 9.8% in 2002 to 8.1% in 2004. Among high school students there was no significant change, with 22.3% as current users.[11]

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 tenth and twelfth graders was lower in 2005 than in 2004, continuing trends that began in 1996. Among those students in eighth grade, incidence increased slightly in 2005 after declining for eight consecutive years. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

Grade	1991 (%)	2004 (%)	2005 (%)	'04-'05 Change (%)	'91-'05 Change (%)
8th	14.3	9.2	9.3	+1.1	-35.0
10th	20.8	16.0	14.9	-6.9	-28.4
12th	28.3	25.0	23.2	-7.2	-18.0

The 2004 National Survey on Drug Abuse and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services estimated that approximately 59.9 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least

[9] *Source*: CDC. Office on Smoking and Health.

[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Trends in Cigarette Smoking Among High School Students ---United States, 1991-2003". May 21, 2004.

[11] CDC. Morbidity and Mortality Weekly Report. "Tobacco Use, Access, and Exposure to Tobacco in Media Among Middle and High School Students in the United States, 2004". April 1, 2005.

once during the 30 days prior to the interview). This estimate represents an incidence rate of 24.9%, which is a decrease from 25.4% in 2003 and 26.0% in 2002. The same survey found that an estimated 11.9% of youths age 12 to 17 were current cigarette smokers in 2004, down from 12.2% in 2003 and 13.0% in 2002.

Price Elasticity of Cigarette Demand

The price elasticity of demand reflects the impact of changes in price on the demand for a product. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5.[12] (In other words, as the price of cigarettes increases by 1.0% the quantity demanded decreases by 0.3% to 0.5%.) A few researchers have estimated price elasticity as high as -1.23. Research focused on youth smoking has found price elasticity levels of up to -1.41.

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[13] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[14] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by Grossman, estimated an elasticity of smoking participation of just -0.12.[15] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost all of the 12% drop in youth smoking over that time.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student

[12] Chalpouka FJ,Warner KE:P.5.
[13] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780. National Bureau of Economic Research. 2000.
[14] Source: Tauras, John A. and Chaloupka, Frank, J.. "Determinants of Smoking Cessation: An Analysis of Young Adult Men and Women". Working Paper No. W7262. National Bureau of Economic Research. 1999.
[15] Michael Grossman. "Individual Behaviors and Substance Use: The Role of Price". Working Paper No. W10948. National Bureau of Economic Research. December 2004.

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 10% increase in cigarette prices, will reduce smoking participation among college students by 2.6% and will reduce the level of smoking among current college students by 6.2%.[16]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[17] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least 1-5 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 1-5 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 10% increase in price leads to a 4.6% reduction in smoking participation.[18]

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

Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[19] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In October 2002, the FDA approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. It is unclear whether it offers a significant advantage over those

[16] Czart et al. "The impact of prices and control policies on cigarette smoking among college students". Contemporary Economic Policy. Western Economic Association. Copyright April 2001.
[17] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.
[18] Powell et al. "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior". Impacteen. February 2003.
[19] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. http:\\tc.bmjjournals.com.

other products.[20] NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another new cessation product on the market since 2003. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[21]

Several new drugs may also appear on the market in the near future. The Food and Drug Administration has granted a priority review, implying an approval decision within six months, to Pfizer and its product varenicline, which is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Sanofi-Synthelabo announced in March 2005 that it would ask for FDA approval to market the drug rimonabant, under the name Acomplia, as an aid to reduce both overeating and smoking. It appears to block signals that control both cravings. On May 14, 2005, Cytos Biotechnology AG announced the successful completion of Phase II testing of a virus-based vaccine, genetically engineered to attract an immune system response against nicotine and its effects. The company now plans to begin Phase III trials. Nabi Biopharmaceuticals has been in Phase II clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with Nicotine molecules. And the Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. It is expected that products such as these will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Workplace Restrictions

In their 1996 study on the effect of workplace smoking bans on cigarette consumption, Evans, Farrelly, and Montgomery found that between 1986 and 1993 smoking participation rates among workers fell 2.6% more than non-workers.[22] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day that a smoker spends working in an environment where there are smoking restrictions, the greater is the decline in the quantity of cigarettes consumed by that smoker.

[20] Niaura, Raymond and Abrams, David B. "Smoking Cessation: Progress, Priorities, and Prospectus". Journal of Consulting and Clinical Psychology. June 2002.
[21] Roddy, Elin. "Bupropion and Other Non-nicotine Pharmacotherapies". *British Medical Journal.* 28 February 2004.
[22] *Source*: Evans, William N.; Farrelly, Matthew C. and Montgomery, Edward. "Do Workplace Smoking Bans Reduce Smoking*?".* Working Paper No. W5567. National Bureau of Economic Research. 1996.

Factors Affecting Cigarette Consumption

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

General Population Growth. Global Insight forecasts that the United States population will increase from 283 million in 2000 to approximately 398 million in 2042. This forecast is consistent with the Bureau of the Census forecast based on the 2000 Census.

Price Elasticity of Demand & Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using data from 1965 to 2003, the long run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average price of a pack of cigarettes in nominal terms was $2.20. This increased to $2.88 per pack in 1999, representing a nominal growth in the price of cigarettes of 30.9% from 1998. During 1999, consumption declined by 6.45%. This was primarily due to a $0.45 per pack increase in November 1998 which was intended to offset the costs of the MSA and agreements with previously settled states. The cigarette manufacturers then increased wholesale prices on seven occasions between August 1999 and April 2002, with the total change aggregating to $0.82. In addition to the wholesale price increases, in 1999 New York and California each increased its state excise tax by $0.50 per pack. In 2001, five states followed suit, and in January 2002, a scheduled increase in the federal excise tax of $0.05 per pack went into effect. By June 2002 the average price per pack had reached $3.73.

Severe budget shortfalls following the 2001 recession led at least 30 states to consider cigarette excise tax increases in 2002. Ultimately 20 states and New York City imposed excise tax increases that year. These increases range from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They averaged $0.47 per pack, and, when weighted by the state population boosted the nationwide average retail price by $0.18. This increased the population-weighted average state excise tax to over $0.60 per pack. The trend continued in 2003, as state fiscal difficulties persisted. Excise tax increases were enacted in 13 states, pushing the average price per pack to over $3.80. This was followed by eleven state tax increases in 2004 and eight in 2005. As a result the population-weighted average state excise tax is now $0.913 per pack. In 2006 at least eight states are considering proposed excise tax increases, including a $1.00 increase outside of the City in a budget proposal by the Governor of the State. In addition, the Mayor of the City has also proposed a $.50 increase within the City.

During this period, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which has been stable since 2003. As 2004 came to a close, the manufacturers raised list prices for the first time since 2002. Reynolds American announced selected increases and a reduction in discounts on most brands of 10 cents per pack. In June 2005 Philip Morris reduced its retail buydown by 5 cents per pack for its lead brands, and Reynolds American announced price increases, effective January 2006, of up to $0.10 per pack on many of its brands. The average price in December 2005 was $4.12 per pack.

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

Premium brands are typically $0.50 to $1.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The increasing availability of cigarette outlets on Indian reservations, where sales are exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes are growing rapidly, though a recent decision by credit card companies that they would not handle cigarette sales has started to have an impact and will dampen this growth. While these sales are not technically exempt from taxation, states are currently having a difficult time enforcing existing statutes and collecting excise taxes on these sales.[23] Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume.

***Changes in Disposable Incom*e**. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[24] However, a few studies found cigarette consumption decreases as disposable income increases.[25] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%.

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[23] *Source*: United States General Accounting Office. "Internet Cigarette Sales". GAO-02-743. August 2002.
[24] Ippolito, et al.; Fuji.
[25] Wasserman, et al.; Townsend et al.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[26] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[27] One study examines the effects of youth smoking on future adult smoking.[28] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there 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 data from the CDC which measures the incidence of smoking in the 12-17 age group as the percentage of the population in this category that first become daily smokers. This percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. We assume that this recent trend peaked in the late 1990s and youth smoking has resumed its longer-term decline.

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

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The dangers of cigarette smoking have been generally known to the public for years. Part of the negative trend in smoking identified in our model may represent the cumulative effect of various health warnings since 1966.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003

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

Alabama joined the other forty-nine states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[29]

The most comprehensive bans have been enacted since 1998 in ten states and a few large cities. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Delaware had banned smoking in all indoor public areas in 2002. These states joined California in imposing comprehensive statewide smoking bans. The California ban has been in place since 1998. Also in 2003, Connecticut, Maine, and Florida passed laws which ban smoking in restaurants and bars. Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. Since then Massachusetts, Montana, Rhode Island, and Vermont have established similar bans. Voters in Washington State passed a ballot initiative in November 2005 which bans smoking in all public places effective January 2006. The restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. In January 2006, New Jersey adopted a comprehensive ban which will go into effect in April 2006. At the same time New Jersey increased the minimum legal age to purchase cigarettes from 18 to 19 years. Three states, Alabama, Alaska, and Utah, also set the minimum age at 19. In December 2005 Chicago passed a smoking ban which also applies within 15 feet of entrances. It went into effect in January 2006, with an exemption for bars until July 2008. And in January the District of Columbia enacted an extensive ban which will be fully in effect in January 2007. It is expected that these restrictions will continue to proliferate. In 2006 at least five states, Arkansas, Colorado, Iowa, Maryland, and Utah, are considering comprehensive bans. California, effective July 1, 2005, has banned smoking in its prisons. On January 26, 2006 the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of January 3, 2006, there were 2,129 municipalities with indoor smoking restrictions. Of these, 441 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 278 governments, and for bars by 205. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars. These numbers grew to 49 for restaurants and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.[30]

Based on the regression analysis using data from 1965 to 2003, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970's have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimate that U.S. workers in smoke-free

[29] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.
[30] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. January 2006.

workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[31] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost 5 cigarettes per person per day.

The trend variable included in our econometric analysis is likely to incorporate some part of the cumulative impact of the various smoking bans and restrictions. Our forecast assumes that the factors, which have contributed to the negative trend in smoking in the U.S. population, continue to contribute to further declines in smoking rates throughout the forecast horizon.

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

Other Considerations

In August 1999, the CDC published Best Practices for Comprehensive Tobacco Control Programs. Citing the success of programs in California and Massachusetts, the CDC recommends comprehensive tobacco control programs to the states. On August 9, 2000, the Surgeon General issued a report, Reducing Tobacco Use ("Surgeon General's Report"), that comprehensively assesses the value and efficacy of the major approaches that have been used to reduce tobacco use. The report concludes that a comprehensive program of educational strategies, treatment of nicotine addiction, regulation of advertising, clean air regulations, restriction of minors' access to tobacco, and increased excise taxation can significantly reduce the prevalence of smoking. The Surgeon General called for increased spending on anti-smoking initiatives by states, up to 25% of their annual settlement proceeds, which is far higher than the approximately 9% allocated from the first year's settlement payments.

The Surgeon General's Report documents evidence of the effectiveness of five major modalities for reducing tobacco use. Educational strategies are shown to be effective in postponing or preventing adolescent smoking. Pharmacologic treatment of nicotine addiction, combined with behavioral support, can enhance abstinence efforts. Regulation of advertising and promotional activities of manufacturers can reduce smoking, particularly among youth. Clean air regulations and restricted minor's access contribute

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

[32] *Source:* Surgeon General's 1988 Report. "The Health Consequences of Smoking – Nicotine Addiction".

[33] *Source*: Council on Scientific Affairs. "Reducing the Addictiveness of Cigarettes". Report to the AMA House of Delegates. June 1998.

to lessening smoking prevalence. And excise tax increases will reduce cigarette consumption. Further support for the efficacy of such programs is provided in an analysis by Farrelly, Pechacek, and Chaloupka.[34] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%. Tauras, et al. estimate that, had state tobacco control spending been maintained at the levels recommended by the CDC, youth smoking rates would have been from 3.3% to 13.5% lower.[35] Also, Farrelly et al. estimate that 22% of the decline in youth smoking from 1999 to 2002 was due to the national "truth" mass media campaign.[36] In 2002, New York City implemented a strategy which sharply increased excise taxes, banned smoking in bars and restaurants, distributed free nicotine patches, and expanded educational efforts. Research by Frieden et al. estimates that smoking prevalence in the City declines by 11% as a result of these measures, an effect consistent with the conclusions of the Surgeon General's Report.[37]

In May 2001 a Commission established by President Clinton in September 2000 released its final report on how to improve economic conditions in tobacco dependent economies while making sure that public health does not suffer in the process.[38] The Commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program (TERP). TERP would allow compensation to be rendered to quota owners for the loss in value of their quota assets as a result of a restructuring to a production permit system where permits would be issued annually to tobacco growers. Also created would be a Center for Tobacco-Dependent Communities, which would address any challenges faced during this period. Three public health proposals that were suggested by the Commission were: that states increase funding on tobacco cessation and prevention programs; that the FDA be allowed to regulate tobacco products in a “fair and equitable” manner; and that funding be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the Commission called for a 17-cent increase in the excise tax on all packs of cigarettes sold in the United States. The increased revenues would then be deposited into a fund and earmarked for the recommended programs. On February 13, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations, which included raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to discourage smoking and to fund anti-tobacco efforts.

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[34] “The Impact of Tobacco Control Program Expenditures on Aggregate Cigarette Sales: 1981-1998.” Working Paper No. 8691,. National Bureau of Economic Research, 2001.

[35] Tauras, Chaloupka, Farrelly, Giovino, Wakefield, Johnston, O'Malley, Kloska, and Pechacek. "State Tobacco Control Spending and Youth Smoking", *American Journal of Public Health*, February 2005.

[36] Farrelly, Davis, Haviland, Messeri, and Healton."Evidence of a Dose-Response Relationship Between "truth" Antismoking Ads and Youth Smoking Prevalence". *American Journal of Public Health.* March 2005.

[37] Frieden, Mostashari, Kerker, Miller, Hajat, and Frankel. "Adult Tobacco Use Levels After Intensive Tobacco Control Measures: New York City, 2002-2003". American Journal of Public Health. June 2005.

[38] “Tobacco at a Crossroad: A Call for Action”. President’s Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health. May 14, 2001.

Neither the Surgeon General's nor the Presidential Commission's report have resulted in a concerted nationwide program to implement their recommendations, though legislation to establish FDA regulation was re-introduced in 2005. Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue. For instance, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Recent research suggests that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.[39] Similarly, the Justice Department has indicated that, as part of a lawsuit against the tobacco companies, it may seek to require graphic health warnings covering 50 percent of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. A similar proposal is part of the World Health Organization's Framework Convention on Tobacco Control, which the U.S. may sign. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either greater levels of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

New York State, in 2000, mandated that manufacturers provide, beginning in 2003, only cigarettes that self-extinguish. These standards went into effect in 2004. In June 2005, Vermont enacted similar legislation which goes into effect May 1, 2006. And in October 2005 California enacted a similar law which will take effect January 1, 2007. We do not believe that these statutes or a nationwide agreement on such standards will affect consumption noticeably. It will probably raise the cost of manufacture slightly, but we view it as a continuation of a long series of government actions that contribute to the trend decline in consumption, which has been incorporated into our model. The expense and availability of technology required in the manufacture of self-extinguishing cigarettes may put the smaller manufacturers at a slight competitive disadvantage, as their cost per pack would increase more relative to the cost per pack increase for the larger manufacturers.

Similarly, in January 2001, Vector Group Ltd. announced plans for a virtually nicotine-free cigarette. The product, Quest, was introduced on January 27, 2003. This non-addictive product might be used as a tool to quit or reduce smoking. We view this as a continuation of efforts to provide products, such as the nicotine patch, that are supposed to reduce smoking addiction. These products have likely contributed to the trend decline in consumption incorporated into our model. In our forecast, we expect such efforts to continue to reduce per capita cigarette consumption.

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

An Empirical Model of Cigarette Consumption

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

1) the real price of cigarettes (cigprice)
2) the level of real disposable income per capita (ydp96pc)
3) the impact of restrictions on smoking in public places (smokeban)
4) the trend over time in individual behavior and preferences (trend)

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with Global Insight's standard adult population growth, and adjustment for non-adult smoking, we projected actual cigarette consumption (in billions of cigarettes) out to 2042. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

Using U.S. data from 1965 through 2003 on the variables described above, we developed the following regression equation. All of the data sources are detailed in Appendix 1 of this Report.

$$\begin{aligned} \log(\text{cpc}) = {} & 57.7 - 0.024 * \text{trend} \\ & - 0.223 * \log(\text{cigprice}) - 0.106 * \log(\text{cigprice})(-1) \\ & + 0.270 * \log(\text{ydp96pc}) - 0.020 * \text{smokeban} \end{aligned}$$

The model is estimated in logarithmic form, since that allows the easy computation of the responsiveness (or elasticity) of the dependent variable (adult per capita cigarette consumption) to changes in the various explanatory (or the right hand side) variables.

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to

2003 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

Our model is completed with two other equations:

(1) Total adult cigarette consumption =

cpc * U.S. adult population.

(2) Total cigarette consumption =

total adult cigarette consumption + total youth cigarette consumption.

We have measured the consumption level of cigarettes in the 12-17 age group by examining the difference between total consumption and total adult consumption. We then use the expected trend of youth smoking incidence to adjust for the volume of cigarette consumption in this age group. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 2.4 billion in 2042.

Dependent Variable

Adult Per Capita Cigarette Consumption (CPC)

CPC measures the average annual cigarette consumption of the American adult. It is calculated by dividing total adult cigarette consumption by the size of the population 18 and above. Of the different measures of cigarette consumption available, this is considered to be the most reliable. It also directly reflects the changing behavior of individual smokers over the historical period. Data were obtained from the U.S. Department of Agriculture's (USDA) Economic Research Service.

Explanatory Variables

The Real Price of Cigarettes (CIGPRICE)

Reliable data on retail cigarette prices from the consumer price index (CPI) are only available since 1997, an inadequate time frame to build our model. However, tobacco CPI, which is available for the entire period of analysis, closely follows cigarette prices, since cigarettes constitute over 95 percent of tobacco products. We have, therefore, used the tobacco CPI in our model, as is standard. Further, we have deflated this price of cigarettes (tobacco) by the overall price level to ensure that any change in cigarette consumption is correctly attributed to a change in the price of cigarettes relative to other goods, rather than an overall change in the price level. The overall, as well as tobacco CPI, were obtained from the Bureau of Labor Statistics (BLS).

The coefficient on CIGPRICE in the regression equation measures the elasticity of cigarette consumption with respect to price. In our model this effect consists of two parts. The coefficient of –0.223 measures the short-run elasticity of cigarette demand. That is, a 1% increase in price reduces consumption by 0.223% in the current year. The second coefficient, -0.106 relates to prices in the previous year. It indicates that, following a 1% increase, an additional decrease in cigarette consumption of 0.106% will occur. Thus, according to the data, a one percent increase in price decreases cigarette consumption by 0.329 percent in the long term. The low value of the elasticity indicates that cigarette consumption is price inelastic, or relatively unresponsive to changes in price. This coefficient is estimated such that a statistical confidence interval of 95% places its value between -0.25 and -0.41. This implies that there is a probability of 5% that the price elasticity is outside this range.

Real Disposable Income Per Capita (YDP96PC)

Real disposable income per capita measures the average income per person after tax in constant 1996 dollars. Data used were collected by the Bureau of Economic Analysis (BEA). For goods considered "normal", consumption increases as incomes rise. Hence the coefficient is positive. On the other hand if the coefficient is negative, it indicates that the good is "inferior" and less is purchased as incomes rise.

Our analysis indicates that the income elasticity of cigarettes, given by the regression coefficient on YDP96PC, is 0.27. The positive sign on the coefficient indicates that cigarettes are a normal good. Specifically, every percent increase in real disposable income per capita has raised adult per capita cigarette consumption by 0.27%. However, the low value of the elasticity indicates that the demand for cigarettes is income inelastic, or relatively unresponsive to changes in income. This coefficient (0.27) is estimated such that a statistical confidence interval of 95% places its value between 0.03 and 0.52. This implies that there is a probability of 5% that the income elasticity is outside this range.

Qualitative variable

The qualitative variable that we have explicitly included in our model relates to the restrictions on public smoking since the 1980s (SMOKEBAN). The negative coefficient on the variable implies that smoking decreases as a result of smoking bans. The coefficient on SMOKEBAN is estimated such that a statistical confidence interval of

95% for its value is from 0 to -0.53. This implies that there is a probability of 5% that the coefficient is outside this range.

Trend and constant term

According to the regression equation specified above, adult cigarette consumption per capita (CPC) displays a trend decline of 2.40 percent per year. The trend reflects the impact of a systematic change in the underlying data that is **not** explained by the included explanatory variables. In the case of cigarette consumption, the systematic change is in public attitudes toward smoking. The trend may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables which are statistically insignificant when viewed in isolation. This trend, primarily due to an increase in the health-conscious proportion of the population averse to smoking, would by itself account for 90.3% of the variation in consumption. This coefficient is estimated such that a statistical confidence interval of 95% for its value is from 0.0195 to 0.0269 (1.95% to 2.69%). This implies that there is a probability of 5% that the trend rate of decline is outside this range.

The constant term (57.7) also reflects the impact of excluded variables, those that stay fixed over time (e.g., the health warnings on cigarette packs). It should be noted that the actual decline in CPC in any given year could be above or below the trend, depending on the values of the other explanatory variables.

Forecast Assumptions

Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard Global Insight forecasts. Annual population growth is projected to average 0.8%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the tobacco settlement. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, and to $4.00 in 2005. After a long period of fighting to maintain market share, the large cigarette manufacturers are expected to reduce discounts and other promotions. In addition many states continue to discuss excise tax increases. We expect prices in 2005 to average $4.08 per pack.

Our model, intended for long-term forecasting, uses annual data to describe changes in prices and other variables. When viewed over long intervals of time, the changes will appear to be gradual. The purpose of the model is to capture these broad changes and their influence on consumption. Because cigarette manufacturing is dominated by a few firms, price changes will typically be discrete events, with jumps such as occurred on August 1999 and December 2004, followed by plateaus, rather than small and continuous changes. The exact timing during the year of price changes influences only the short-term path of consumption.

Our forecast assumptions have incorporated price increases in excess of general inflation in order to meet the requirements of the MSA and offset excise and other taxes. Based upon our general inflation and cost assumptions, we anticipate that the nominal price per pack of cigarettes will rise to $22.99 by 2042, which is $7.60 in 2000 dollars. Relative to other goods, cigarette prices will rise by an average of 2.2% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

Prior to the MSA, only once, in 1983, have real cigarette prices appreciated at a double digit, or greater than 10%, rate. If a 10% rate of price increase were to continue, the annual rate of decline in cigarette consumption predicted by our model would increase to approximately 4%.

Our Base Case Forecast assumes that the incidence of youth smoking will continue to decline. By 2042 we assume that youth smoking will have declined at an average annual rate of 2.10% since 2001, or by 60% overall.

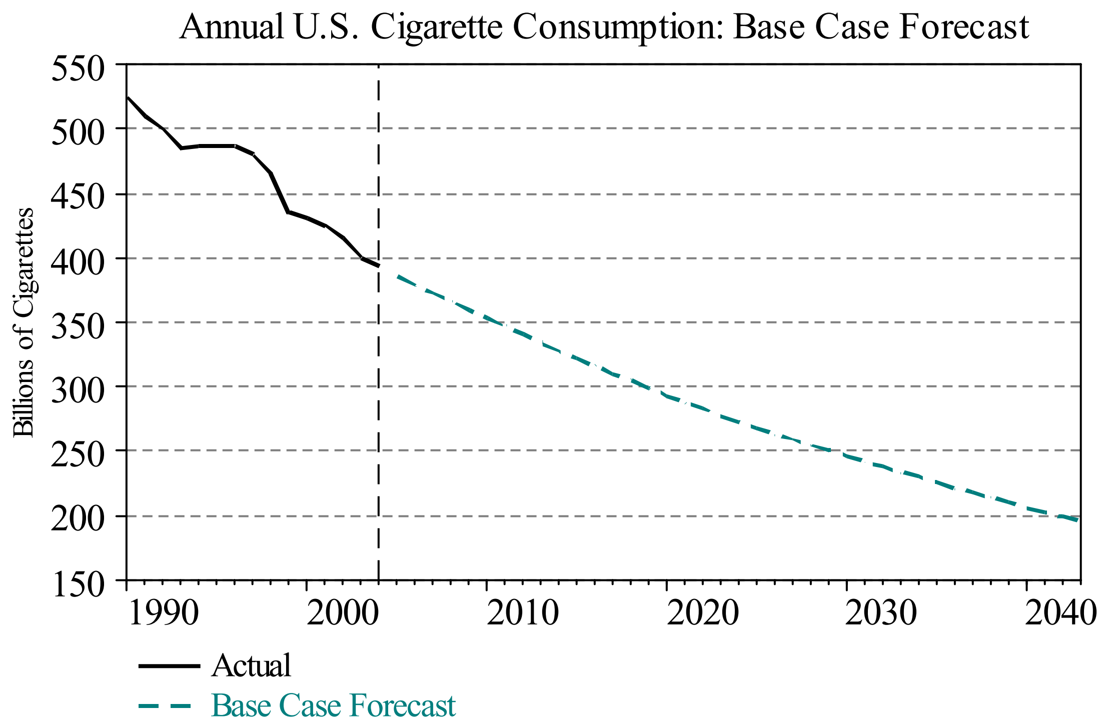
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

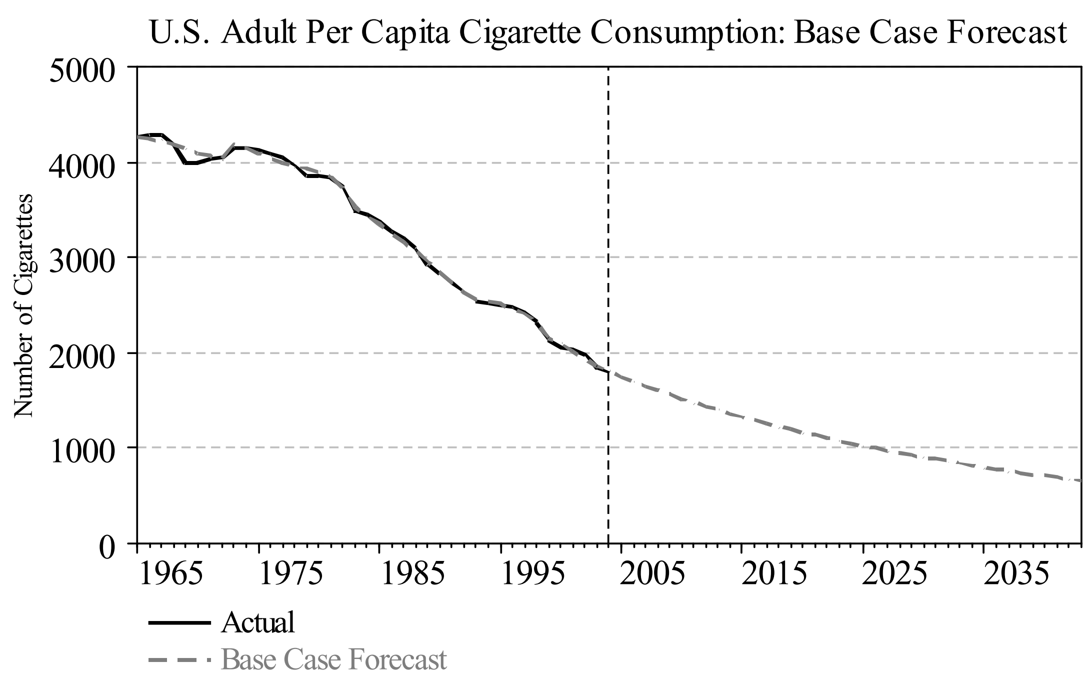
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2004 through 2042. Then using the standard adult population projections of Global Insight's macroeconomic model, we converted per capita consumption to aggregate adult consumption. We then added our estimate of teenage smoking volume going forward.

In using regression equations developed on the basis of historical data to project future values of the dependent variable, we must also assume that the underlying economic structure captured in the equation will remain essentially the same. While past performance is no guarantee of future patterns, it is still the best tool we have to make such projections.

The graphs below display the projected time trend of U.S. cigarette consumption. The first graph illustrates total actual and projected cigarette consumption in the United States. The second graph illustrates actual and projected CPC in the United States. For the period 1965 through 2003 the forecast line on the second graph indicates the value of CPC our model would have projected for those years.





In addition to the expected trend decline in cigarette consumption, the sharp upward shock to cigarette prices in late 1998 and 1999 contributed to a 6.45% reduction in consumption in 1999. The rate of decline has moderated considerably since that time, averaging -2.1% from 1999 to 2003. Total industry shipments for 2004 have been reported at 394.5 billion, a 1.7% decline from 2003. The deep discount share of the market has been reported by the manufacturers as having stabilized at about 12% for 2003 and 2004. These cigarettes are produced by a large number of manufacturers, including many who participate in the MSA. After significant gains earlier in the decade, imports to the U.S. declined in 2004 by 2.2% to 22.3 billion sticks. For the third quarter of 2005 industry shipments of 99.1 billion cigarettes were 1.9% below the prior-year period. For the first three quarters of 2005 shipments were down 2.8% from the prior year. Part of this decline can be attributed to an extra shipping day in the leap year 2004.

After 2003, the rate of decline of consumption is projected to moderate and average less than 2% per year. From 2004 through 2042 the average annual rate of decline is projected to be 1.78%. On a per capita basis consumption is projected to fall at an average rate of 2.55% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 393 billion in 2004 to 385 billion in 2005, under 300 billion by 2019, and to under 200 billion by 2042.

Statistical Confidence and Forecast Error

In addition to potential forecast errors due to incorrect forecast assumptions, there also exists possible error in the statistical estimation. The estimation and development of an econometric model is a statistical exercise. Thus, our parameters are estimated with some degree of error. We have provided confidence intervals for the coefficient (elasticity) estimates. For instance, there is a 2.5% probability (5%/2) that the price elasticity exceeds 0.38. There is similarly a 2.5% chance that the income elasticity is less than 0.03. But if these events were independent, the probability of both would be .025 x .025 = .000625, or .0625%, less than one tenth of one percent.

Comparison With Prior Forecasts

In August 2002 Global Insight presented a similar study, “A Forecast of U.S. Cigarette Consumption (2001-2042).” Its long run conclusions were quite similar to this study. The current forecast of consumption for the year 2042 is 5.3% less than that of the original study, 199.0 billion vs. 210.1 billion.

The new data available, now for over five years after the MSA, has also allowed us to re-estimate and update the econometric coefficients of our consumption model. In doing so, we have modified, on the basis of the statistical evidence through 2003, two important parameters used in our forecast model. First, we have found that, when taking into account the consumption response to the large price increases from 1999 to 2003, the price elasticity of demand is slightly higher, at -0.33, than the -0.31 previously estimated. The implication is that each additional 10% increase in the real price of cigarettes will reduce consumption by 3.3%. Previously our model had assumed a consumption response of 3.1% following a 10% price change. Second, the underlying trend decline in per-capita cigarette consumption has been found, also based on statistical evidence through 2003, to be 2.4% per year, slightly higher than the 2.3% per year assumed in the earlier report.

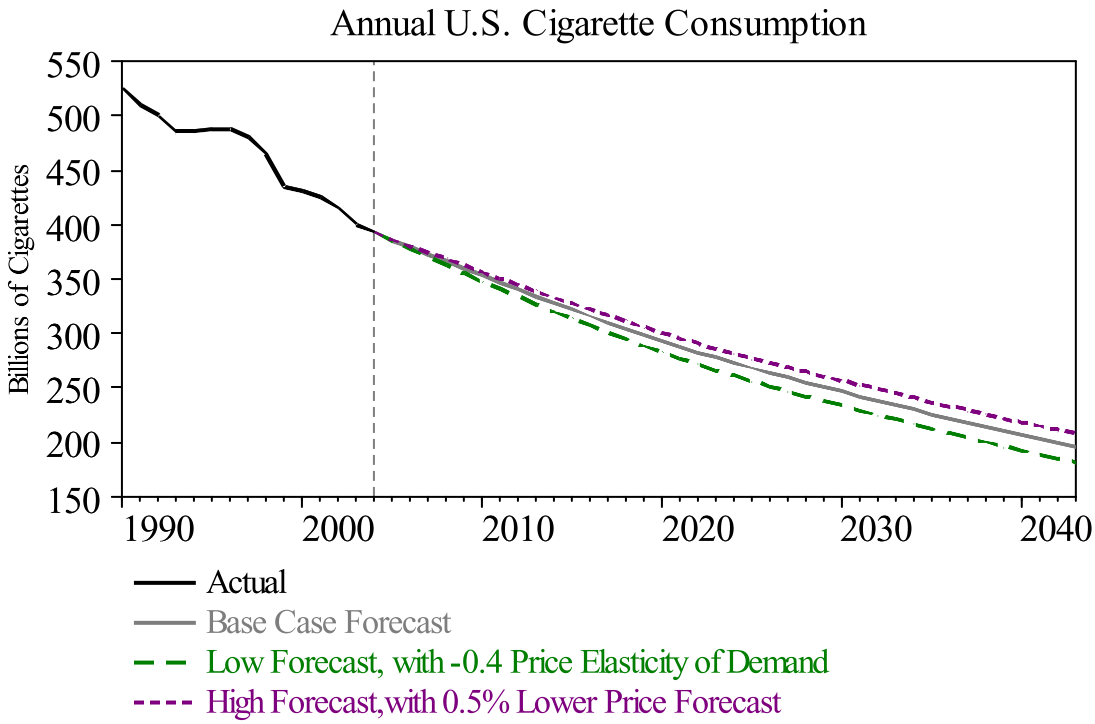
The implications of these changes are to increase the long term rate of decline of consumption to 1.78% per year, from 1.69% as projected in 2002. The net result of all of these changes is that 2042 consumption is now projected to be 11 billion sticks lower than our 2002 forecast.

Alternative Forecasts

Two sources of variance may appear in the forecast derived by our model. First, as detailed in the Explanatory Variables section, there is some degree of forecast error in the parameters of the model. Second, the time paths of the explanatory variables may differ from our Base Case Forecast assumptions. Alternative forecasts are included in order to provide an interval forecast that, in our opinion, encompasses all of the likely potential realizations over time.

The high and low alternative forecasts are derived as follows. For the high scenario, we use a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than our current base case forecast. Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.78% to 1.62%, resulting in consumption of 211 billion in 2042.

In the low forecast, Low Case 1, we posit a sharper price elasticity of demand. Our estimate of the price elasticity, -0.33, is on the low end of the range when compared to that of certain other economic researchers. Recent economic research has forged a consensus that the elasticity lies between –0.3 and –0.5. We have, therefore, used a higher elasticity of –0.4, to generate the lowest consumption forecast which might be reasonably anticipated by our model. This increases the average rate of decline to 1.96% and results in cigarette consumption of 185 billion in 2042.



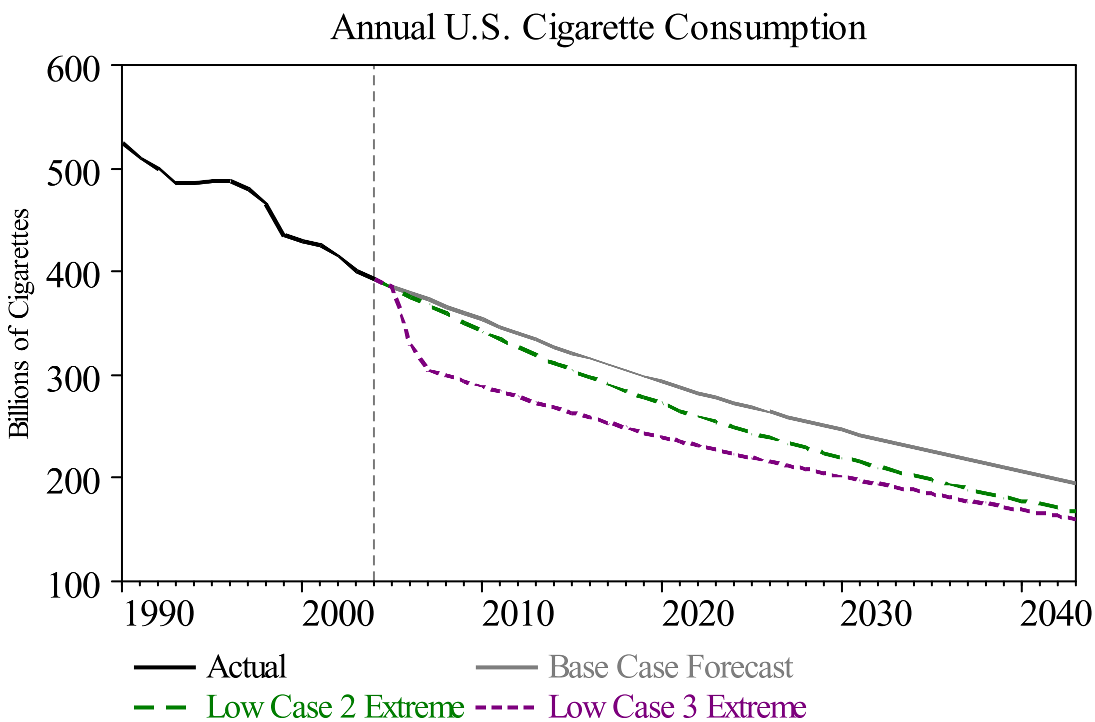
Hypothetical Stress Scenarios

The model was also tested under more extreme, and concurrently, less likely conditions. These exercises do not represent informed anticipation of possible future conditions. Rather, they are meant only to test the model under extreme conditions. First, we increased the negative response of consumer demand to recent price increases by assuming a much larger, -0.5, elasticity. This sharpens the fall in total consumption to an average annual rate of 2.17%, and results in demand of 171 billion cigarettes in 2042 (Low Case 2). This scenario would also be the result if, instead of a greater price sensitivity of smokers, we postulated an increased rate of cigarette price increase. Indeed, if cigarette prices, instead of averaging increases in real terms of 2.2% per year, accelerated to a pace of 3.7% annually, demand would also fall to 171 billion in 2042.

A second large negative stress is placed by postulating, in 2006, either an adverse federal government settlement, or tort claims of three times the size of this MSA. This would result in a real price increase of 57%, and a large decline, 18% over two years, in consumption. By 2042, consumption will have fallen to 163 billion cigarettes, an average annual rate of decline of 2.29% (Low Case 3).

Alternative Forecasts

	2042 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	199	1.78
Low Case 1	185	1.96
High Alternative	211	1.62
Low Case 2	171	2.17
Low Case 3	163	2.29



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4%. At 3.5% per year consumption falls to 101 billion by 2042 and at 4% it falls to 83 billion. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

Base Case Forecast: Assumptions for Explanatory Variables

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
1965	4.84	4.13	1.95	0.04		
1966	4.06	0.92	1.28	0.04		
1967	3.27	0.72	1.39	0.05		
1968	3.50	1.89	1.56	0.05		
1969	2.06	0.00	1.69	0.06		
1970	3.02	2.24	2.00	0.05		
1971	3.28	0.12	2.27	0.06		
1972	3.66	2.08	2.85	0.06		
1973	5.73	-3.29	2.03	0.07		
1974	-1.62	-5.49	2.05	0.07		
1975	1.30	-1.87	2.12	0.05		
1976	2.92	-1.40	2.07	0.05		
1977	2.46	-1.60	1.91	0.07		
1978	3.58	-2.05	1.91	0.06		
1979	1.35	-4.73	2.00	0.05		
1980	0.06	-5.03	1.96	0.05		
1981	1.63	-2.11	1.73	0.06		
1982	1.20	4.80	1.64	0.05		
1983	2.35	15.84	1.46	0.04		
1984	6.63	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.21	4.84	1.38	0.06		
1987	0.83	3.36	1.23	0.05		
1988	3.32	4.83	1.26	0.05		
1989	1.82	7.64	1.35	0.05		
1990	0.72	4.71	0.89	0.06	7.96	
1991	-0.81	7.16	0.96	0.06	7.72	
1992	2.08	5.24	0.99	0.06	7.62	
1993	-0.24	0.91	1.02	0.06	7.12	
1994	1.48	-6.11	0.95	0.07	7.21	
1995	1.58	-0.21	0.85	0.07	7.76	
1996	1.77	0.18	0.89	0.08	7.54	
1997	2.30	2.31	1.27	0.08	6.58	
1998	4.63	11.03	1.15	0.08	6.30	2.20
1999	1.80	26.72	1.13	0.08	5.92	2.88
2000	3.71	7.47	1.14	0.08	5.92	3.20
2001	0.89	4.36	1.10	0.08	5.92	3.45
2002	2.06	5.76	1.02	0.08	5.91	3.71
2003	1.32	-0.64	0.96	0.08	5.87	3.77
2004	2.46	-0.75	0.87	0.08	5.84	3.84
2005	1.90	4.21	0.98	0.08	5.82	4.08
2006	2.24	2.59	0.89	0.08	5.80	4.27
2007	2.19	2.63	1.00	0.08	5.78	4.47
2008	2.22	2.71	1.00	0.08	5.77	4.68
2009	2.00	3.10	1.02	0.07	5.77	4.92

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Price Per Pack of Cigarettes
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*%*	*Billions*	*$ (Current)*
2010	2.21	2.61	1.00	0.07	5.62	5.17
2011	2.23	2.57	0.93	0.07	5.47	5.42
2012	2.02	2.52	0.88	0.07	5.32	5.71
2013	2.02	2.48	0.81	0.07	5.18	6.01
2014	2.02	2.84	0.80	0.07	5.18	6.35
2015	2.04	2.02	0.84	0.07	5.18	6.66
2016	2.04	2.37	0.82	0.07	5.18	7.00
2017	2.05	2.34	0.77	0.07	5.18	7.36
2018	2.05	2.31	0.76	0.07	5.18	7.74
2019	2.06	2.27	0.74	0.06	5.03	8.13
2020	2.08	1.89	0.76	0.06	4.88	8.52
2021	2.09	2.22	0.77	0.06	4.73	8.94
2022	2.10	1.85	0.77	0.06	4.59	9.36
2023	2.11	2.17	0.78	0.06	4.44	9.83
2024	2.11	1.81	0.78	0.06	4.44	10.28
2025	2.11	1.79	0.79	0.05	4.29	10.75
2026	2.11	1.78	0.79	0.05	4.14	11.24
2027	2.11	1.76	0.79	0.05	3.99	11.76
2028	2.11	1.75	0.80	0.05	3.85	12.29
2029	2.11	1.73	0.80	0.05	3.70	12.85
2030	2.11	2.02	0.80	0.05	3.70	13.47
2031	2.11	1.70	0.79	0.04	3.55	14.07
2032	2.11	1.68	0.77	0.04	3.40	14.70
2033	2.11	1.67	0.76	0.04	3.25	15.36
2034	2.11	1.66	0.75	0.04	3.11	16.04
2035	2.11	2.50	0.74	0.04	2.96	16.90
2036	2.11	1.62	0.72	0.04	2.96	17.64
2037	2.11	1.89	0.71	0.04	2.96	18.47
2038	2.11	1.59	0.70	0.04	2.96	19.28
2039	2.11	1.85	0.69	0.03	2.81	20.18
2040	2.11	1.57	0.68	0.03	2.66	21.06
2041	2.11	1.56	0.67	0.03	2.51	21.97
2042	2.11	1.81	0.66	0.03	2.37	22.99

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2042)

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2320	-4.25	465.00	23.25	-3.13
1999	2136	-7.93	435.00	21.75	-6.45
2000	2056	-3.75	430.00	21.50	-1.15
2001	2026	-1.46	425.00	21.25	-1.16
2002	1979	-2.32	415.00	20.75	-2.35
2003	1837	-7.18	400.00	20.00	-3.61
2004	1791	-2.50	393.00	19.65	-1.75

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
2005	1738	-2.96	385.10	19.25	-2.01
2006	1694	-2.51	378.67	18.93	-1.67
2007	1650	-2.62	372.43	18.62	-1.65
2008	1606	-2.69	366.17	18.31	-1.68
2009	1560	-2.84	359.37	17.97	-1.86
2010	1518	-2.73	353.07	17.65	-1.76
2011	1477	-2.66	346.82	17.34	-1.77
2012	1437	-2.70	340.38	17.02	-1.86
2013	1399	-2.69	333.89	16.69	-1.91
2014	1360	-2.76	327.38	16.37	-1.95
2015	1325	-2.62	321.60	16.08	-1.77
2016	1290	-2.61	315.88	15.79	-1.78
2017	1256	-2.63	310.02	15.50	-1.85
2018	1223	-2.62	304.28	15.21	-1.85
2019	1191	-2.61	298.49	14.92	-1.90
2020	1161	-2.53	293.13	14.66	-1.80
2021	1131	-2.56	287.77	14.39	-1.83
2022	1103	-2.51	282.63	14.13	-1.79
2023	1075	-2.54	277.53	13.88	-1.81
2024	1048	-2.49	272.80	13.64	-1.71
2025	1023	-2.45	268.13	13.41	-1.71
2026	998	-2.44	263.58	13.18	-1.70
2027	973	-2.44	259.12	12.96	-1.69
2028	950	-2.43	254.77	12.74	-1.68
2029	927	-2.43	250.49	12.52	-1.68
2030	904	-2.49	246.28	12.31	-1.68
2031	881	-2.45	242.04	12.10	-1.72
2032	860	-2.42	237.93	11.90	-1.70
2033	839	-2.41	233.89	11.69	-1.70
2034	819	-2.41	229.87	11.49	-1.72
2035	798	-2.59	225.49	11.27	-1.91
2036	778	-2.49	221.53	11.08	-1.76
2037	759	-2.45	217.67	10.88	-1.74
2038	741	-2.42	213.95	10.70	-1.71
2039	723	-2.44	210.08	10.50	-1.81
2040	705	-2.41	206.33	10.32	-1.79
2041	688	-2.38	202.69	10.13	-1.77
2042	672	-2.43	198.98	9.95	-1.83

Base Case and Alternative Forecasts of Total U.S. Cigarette Consumption

Year	Base Case Forecast			Low Case 1: -0.4 Price Elasticity of Demand			High Forecast: Lower Price Assumption		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2004	393.00	19.65	-1.75	393.00	19.65	-1.75	393.00	19.65	-1.75
2005	385.10	19.25	-2.01	384.39	19.22	-2.19	385.77	19.29	-1.84
2006	378.67	18.93	-1.67	377.13	18.86	-1.89	379.99	19.00	-1.50
2007	372.43	18.62	-1.65	369.97	18.50	-1.90	374.33	18.72	-1.49
2008	366.17	18.31	-1.68	362.68	18.13	-1.97	368.45	18.42	-1.57
2009	359.37	17.97	-1.86	354.93	17.75	-2.14	362.16	18.11	-1.71
2010	353.07	17.65	-1.76	347.85	17.39	-2.00	356.35	17.82	-1.61
2011	346.82	17.34	-1.77	340.90	17.04	-2.00	350.62	17.53	-1.61
2012	340.38	17.02	-1.86	333.78	16.69	-2.09	344.63	17.23	-1.71
2013	333.89	16.69	-1.91	326.65	16.33	-2.14	338.58	16.93	-1.76
2014	327.38	16.37	-1.95	319.46	15.97	-2.20	332.52	16.63	-1.79
2015	321.60	16.08	-1.77	313.25	15.66	-1.95	327.14	16.36	-1.62
2016	315.88	15.79	-1.78	307.02	15.35	-1.99	321.81	16.09	-1.63
2017	310.02	15.50	-1.85	300.68	15.03	-2.06	316.36	15.82	-1.69
2018	304.28	15.21	-1.85	294.51	14.73	-2.05	311.01	15.55	-1.69
2019	298.49	14.92	-1.90	288.29	14.41	-2.11	305.56	15.28	-1.75
2020	293.13	14.66	-1.80	282.59	14.13	-1.98	300.53	15.03	-1.65
2021	287.77	14.39	-1.83	276.87	13.84	-2.03	295.49	14.77	-1.68
2022	282.63	14.13	-1.79	271.48	13.57	-1.95	290.69	14.53	-1.63
2023	277.53	13.88	-1.81	266.06	13.30	-2.00	285.90	14.30	-1.65
2024	272.80	13.64	-1.71	261.10	13.05	-1.87	281.49	14.07	-1.55
2025	268.13	13.41	-1.71	256.22	12.81	-1.87	277.12	13.86	-1.55
2026	263.58	13.18	-1.70	251.45	12.57	-1.86	272.85	13.64	-1.54
2027	259.12	12.96	-1.69	246.80	12.34	-1.85	268.65	13.43	-1.54
2028	254.77	12.74	-1.68	242.26	12.11	-1.84	264.54	13.23	-1.53
2029	250.49	12.52	-1.68	237.83	11.89	-1.83	260.52	13.03	-1.52
2030	246.28	12.31	-1.68	233.37	11.67	-1.87	256.53	12.83	-1.53
2031	242.04	12.10	-1.72	229.01	11.45	-1.87	252.53	12.63	-1.56
2032	237.93	11.90	-1.70	224.77	11.24	-1.85	248.64	12.43	-1.54
2033	233.89	11.69	-1.70	220.62	11.03	-1.85	244.79	12.24	-1.55
2034	229.87	11.49	-1.72	216.50	10.83	-1.87	240.98	12.05	-1.56
2035	225.49	11.27	-1.91	211.88	10.59	-2.14	236.75	11.84	-1.76
2036	221.53	11.08	-1.76	207.86	10.39	-1.90	232.97	11.65	-1.60
2037	217.67	10.88	-1.74	203.89	10.19	-1.91	229.29	11.46	-1.58
2038	213.95	10.70	-1.71	200.12	10.01	-1.85	225.74	11.29	-1.55
2039	210.08	10.50	-1.81	196.16	9.81	-1.98	221.99	11.10	-1.66
2040	206.33	10.32	-1.79	192.38	9.62	-1.93	218.38	10.92	-1.63
2041	202.69	10.13	-1.77	188.71	9.44	-1.91	214.85	10.74	-1.62
2042	198.98	9.95	-1.83	184.94	9.25	-2.00	211.25	10.56	-1.68

Base Case Forecast and Low Case Extreme Projections

Year	Base Case Forecast			Low Case 2: -0.5 Price Elasticity of Demand			Low Case 3: Large MSA in 2006		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2004	393.00	19.65	-1.75	393.00	19.65	-1.75	393.00	19.65	-1.75
2005	385.10	19.25	-2.01	383.57	19.18	-2.40	385.10	19.25	-2.01
2006	378.67	18.93	-1.67	375.32	18.77	-2.15	329.88	16.49	-14.34
2007	372.43	18.62	-1.65	367.15	18.36	-2.18	304.51	15.23	-7.69
2008	366.17	18.31	-1.68	358.92	17.95	-2.24	299.39	14.97	-1.68
2009	359.37	17.97	-1.86	350.14	17.51	-2.45	293.83	14.69	-1.86
2010	353.07	17.65	-1.76	342.25	17.11	-2.26	288.68	14.43	-1.76
2011	346.82	17.34	-1.77	334.52	16.73	-2.26	283.57	14.18	-1.77
2012	340.38	17.02	-1.86	326.70	16.33	-2.34	278.30	13.92	-1.86
2013	333.89	16.69	-1.91	318.93	15.95	-2.38	273.00	13.65	-1.91
2014	327.38	16.37	-1.95	310.99	15.55	-2.49	267.67	13.38	-1.95
2015	321.60	16.08	-1.77	304.32	15.22	-2.15	262.95	13.15	-1.77
2016	315.88	15.79	-1.78	297.53	14.88	-2.23	258.27	12.91	-1.78
2017	310.02	15.50	-1.85	290.71	14.54	-2.29	253.48	12.67	-1.85
2018	304.28	15.21	-1.85	284.07	14.20	-2.28	248.79	12.44	-1.85
2019	298.49	14.92	-1.90	277.42	13.87	-2.34	244.05	12.20	-1.90
2020	293.13	14.66	-1.80	271.44	13.57	-2.16	239.67	11.98	-1.80
2021	287.77	14.39	-1.83	265.34	13.27	-2.25	235.29	11.76	-1.83
2022	282.63	14.13	-1.79	259.67	12.98	-2.14	231.09	11.55	-1.79
2023	277.53	13.88	-1.81	253.92	12.70	-2.22	226.92	11.35	-1.81
2024	272.80	13.64	-1.71	248.73	12.44	-2.05	223.05	11.15	-1.71
2025	268.13	13.41	-1.71	243.63	12.18	-2.05	219.23	10.96	-1.71
2026	263.58	13.18	-1.70	238.66	11.93	-2.04	215.51	10.78	-1.70
2027	259.12	12.96	-1.69	233.81	11.69	-2.03	211.86	10.59	-1.69
2028	254.77	12.74	-1.68	229.11	11.46	-2.01	208.31	10.42	-1.68
2029	250.49	12.52	-1.68	224.51	11.23	-2.01	204.81	10.24	-1.68
2030	246.28	12.31	-1.68	219.86	10.99	-2.07	201.36	10.07	-1.68
2031	242.04	12.10	-1.72	215.37	10.77	-2.04	197.90	9.89	-1.72
2032	237.93	11.90	-1.70	211.02	10.55	-2.02	194.54	9.73	-1.70
2033	233.89	11.69	-1.70	206.77	10.34	-2.02	191.23	9.56	-1.70
2034	229.87	11.49	-1.72	202.57	10.13	-2.03	187.95	9.40	-1.72
2035	225.49	11.27	-1.91	197.74	9.89	-2.39	184.37	9.22	-1.91
2036	221.53	11.08	-1.76	193.65	9.68	-2.07	181.13	9.06	-1.76
2037	217.67	10.88	-1.74	189.61	9.48	-2.09	177.98	8.90	-1.74
2038	213.95	10.70	-1.71	185.80	9.29	-2.01	174.93	8.75	-1.71
2039	210.08	10.50	-1.81	181.77	9.09	-2.17	171.77	8.59	-1.81
2040	206.33	10.32	-1.79	177.97	8.90	-2.09	168.70	8.43	-1.79
2041	202.69	10.13	-1.77	174.30	8.71	-2.07	165.72	8.29	-1.77
2042	198.98	9.95	-1.83	170.50	8.53	-2.18	162.69	8.13	-1.83

Alternative Constant Rate Decline Projections

Year	3.5% Decline Per Year			4.0% Decline Per Year		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
2004	393.00	19.65	-1.75	393.00	19.65	-4.00
2005	379.25	18.96	-3.5	377.28	18.86	-4.00
2006	365.97	18.30	-3.5	362.19	18.11	-4.00
2007	353.16	17.66	-3.5	347.70	17.39	-4.00
2008	340.80	17.04	-3.5	333.79	16.69	-4.00
2009	328.87	16.44	-3.5	320.44	16.02	-4.00
2010	317.36	15.87	-3.5	307.62	15.38	-4.00
2011	306.26	15.31	-3.5	295.32	14.77	-4.00
2012	295.54	14.78	-3.5	283.51	14.18	-4.00
2013	285.19	14.26	-3.5	272.17	13.61	-4.00
2014	275.21	13.76	-3.5	261.28	13.06	-4.00
2015	265.58	13.28	-3.5	250.83	12.54	-4.00
2016	256.28	12.81	-3.5	240.79	12.04	-4.00
2017	247.31	12.37	-3.5	231.16	11.56	-4.00
2018	238.66	11.93	-3.5	221.92	11.10	-4.00
2019	230.30	11.52	-3.5	213.04	10.65	-4.00
2020	222.24	11.11	-3.5	204.52	10.23	-4.00
2021	214.47	10.72	-3.5	196.34	9.82	-4.00
2022	206.96	10.35	-3.5	188.48	9.42	-4.00
2023	199.72	9.99	-3.5	180.94	9.05	-4.00
2024	192.73	9.64	-3.5	173.71	8.69	-4.00
2025	185.98	9.30	-3.5	166.76	8.34	-4.00
2026	179.47	8.97	-3.5	160.09	8.00	-4.00
2027	173.19	8.66	-3.5	153.68	7.68	-4.00
2028	167.13	8.36	-3.5	147.54	7.38	-4.00
2029	161.28	8.06	-3.5	141.64	7.08	-4.00
2030	155.63	7.78	-3.5	135.97	6.80	-4.00
2031	150.19	7.51	-3.5	130.53	6.53	-4.00
2032	144.93	7.25	-3.5	125.31	6.27	-4.00
2033	139.86	6.99	-3.5	120.30	6.01	-4.00
2034	134.96	6.75	-3.5	115.49	5.77	-4.00
2035	130.24	6.51	-3.5	110.87	5.54	-4.00
2036	125.68	6.28	-3.5	106.43	5.32	-4.00
2037	121.28	6.06	-3.5	102.17	5.11	-4.00
2038	117.04	5.85	-3.5	98.09	4.90	-4.00
2039	112.94	5.65	-3.5	94.16	4.71	-4.00
2040	108.99	5.45	-3.5	90.40	4.52	-4.00
2041	105.17	5.26	-3.5	86.78	4.34	-4.00
2042	101.49	5.07	-3.5	83.31	4.17	-4.00

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

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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.

(iii) 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)(1) or (b)(2) above and the substance of such term before it was revised was also a term of the Consent Decree, each affected Settling State and each affected Participating Manufacturer shall jointly move the Court to amend the Consent Decree to conform the terms of the Consent Decree to the revised terms of the Agreement.

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

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

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

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

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

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

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

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

(j) Amendment and Waiver. This Agreement may be amended by a written instrument executed by all Participating Manufacturers affected by the amendment and by all Settling States affected by the amendment. The terms of any such amendment shall not be enforceable in any Settling State that is not a signatory to such amendment. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving party or parties. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, nor shall such waiver be deemed to be or construed as a waiver by any other party.

(k) Notices. All notices or other communications to any party to this Agreement shall be in writing (including, but not limited to, facsimile, telex, telecopy or similar writing) and shall be given at the addresses specified in Exhibit P (as it may be amended to reflect any additional Participating Manufacturer that becomes a party to this Agreement after the MSA Execution Date). Any Settling State or Participating Manufacturer may change or add the name and address of the persons designated to receive notice on its behalf by notice given (effective upon the giving of such notice) as provided in this subsection.

(l) Cooperation. Each Settling State and each Participating Manufacturer agrees to use its best efforts and to cooperate with each other to cause this Agreement and the Consent Decrees to become effective, to obtain all necessary approvals, consents and authorizations, if any, and to execute all documents and to take such other action as may be appropriate in connection herewith. Consistent with the foregoing, each Settling State and each Participating Manufacturer agrees that it will not directly or indirectly assist or encourage any challenge to this Agreement or any Consent Decree by any other person, and will support the integrity and enforcement of the terms of this Agreement and the Consent Decrees. Each Settling State shall use its best efforts to cause State-Specific Finality to occur as to such Settling State.

(m) Designees to Discuss Disputes. Within 14 days after the MSA Execution Date, each Settling State's Attorney General and each Participating Manufacturer shall provide written notice of its designation of a senior representative to discuss with the other signatories to this Agreement any disputes and/or other issues that may arise with respect to this Agreement. Each Settling State's Attorney General shall provide such notice of the name, address and telephone number of the person it has so designated to each Participating Manufacturer and to NAAG. Each Participating Manufacturer shall provide such notice of the name, address and telephone number of the person it has so designated to each Settling State's Attorney General, to NAAG and to each other Participating Manufacturer.

(n) Governing Law. This Agreement (other than the Escrow Agreement) shall be governed by the laws of the relevant Settling State, without regard to the conflict of law rules of such Settling State. The Escrow Agreement shall be governed by the laws of the State in which the Escrow Court is located, without regard to the conflict of law rules of such State.

(o) Severability.

(1) Sections VI, VII, IX, X, XI, XII, XIII, XIV, XVI, XVIII(b), (c), (d), (e), (f), (g), (h), (o), (p), (r), (s), (u), (w), (z), (bb), (dd), and Exhibits A, B, and E hereof ("Nonseverable Provisions") are not severable, except to the extent that severance of section VI is permitted by Settling States pursuant to subsection VI(i) hereof. The remaining terms of this Agreement are severable, as set forth herein.

(2) If a court materially modifies, renders unenforceable, or finds to be unlawful any of the Nonseverable Provisions, the NAAG executive committee shall select a team of Attorneys General (the "Negotiating Team") to attempt to negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment (a "Substitute Term") with the Original Participating Manufacturers. In the event that the court referred to in the preceding sentence is located in a Settling State, the Negotiating Team shall include the Attorney General of such Settling State. The Original Participating Manufacturers shall have no obligation to agree to any Substitute Term. If any Original Participating Manufacturer does not agree to a Substitute Term, this Agreement shall be terminated in all Settling States affected by the court's ruling. The Negotiating Team shall submit any proposed Substitute Term negotiated by the Negotiating Team and agreed to by all of the Original Participating Manufacturers to the Attorneys General of all of the affected Settling States for their approval. If any affected Settling State does not approve the proposed Substitute Term, this Agreement in such Settling State shall be terminated.

(3) If a court materially modifies, renders unenforceable, or finds to be unlawful any term of this Agreement other than a Nonseverable Provision:

(A) The remaining terms of this Agreement shall remain in full force and effect.

(B) Each Settling State whose rights or obligations under this Agreement are affected by the court's decision in question (the "Affected Settling State") and the Participating Manufacturers agree to negotiate in good faith a Substitute Term. Any agreement on a Substitute Term reached between the Participating Manufacturers and the Affected Settling State shall not modify or amend the terms of this Agreement with regard to any other Settling State.

(C) If the Affected Settling State and the Participating Manufacturers are unable to agree on a Substitute Term, then they will submit the issue to non-binding mediation. If mediation fails to produce agreement to a Substitute Term, then that term shall be severed and the remainder of this Agreement shall remain in full force and effect.

(4) If a court materially modifies, renders unenforceable, or finds to be unlawful any portion of any provision of this Agreement, the remaining portions of such provision shall be unenforceable with respect to the affected Settling State unless a Substitute Term is arrived at pursuant to subsection (o)(2) or (o)(3) hereof, whichever is applicable.

(p) Intended Beneficiaries. No portion of this Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a Settling State or a Released Party. No Settling State may assign or otherwise convey any right to enforce any provision of this Agreement.

(q) Counterparts. This Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date affixed, although the original signature pages shall thereafter be appended.

(r) Applicability. The obligations and duties of each Participating Manufacturer set forth herein are applicable only to actions taken (or omitted to be taken) within the States. This subsection (r) shall not be construed as extending the territorial scope of any obligation or duty set forth herein whose scope is otherwise limited by the terms hereof.

(s) Preservation of Privilege. Nothing contained in this Agreement or any Consent Decree, and no act required to be performed pursuant to this Agreement or any Consent Decree, is intended to constitute, cause or effect any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint defense privilege, and each Settling State and each Participating Manufacturer agrees that it shall not make or cause to be made in any forum any assertion to the contrary.

(t) Non-Release. Except as otherwise specifically provided in this Agreement, nothing in this Agreement shall limit, prejudice or otherwise interfere with the rights of any Settling State or any Participating Manufacturer to pursue any and all rights and remedies it may have against any Non-Participating Manufacturer or other non-Released Party.

(u) Termination.

(1) Unless otherwise agreed to by each of the Original Participating Manufacturers and the Settling State in question, in the event that (A) State-Specific Finality in a Settling State does not occur in such Settling State on or before December 31, 2001; or (B) this Agreement or the Consent Decree has been disapproved by the Court (or, in the event of an appeal from or review of a decision of the Court to approve this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review), and the time to Appeal from such disapproval has expired, or, in the event of an Appeal from such disapproval, the Appeal has been dismissed or the disapproval has been affirmed by the court of last resort to which such Appeal has been taken and such dismissal or disapproval has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court); or (C) this Agreement is terminated in a Settling State for whatever reason (including, but not limited to, pursuant to subsection XVIII(o) of this Agreement), then this Agreement and all of its terms (except for the non-admissibility provisions hereof, which shall continue in full force and effect) shall be canceled and terminated with respect to such Settling State, and it and all orders issued by the courts in such Settling State pursuant hereto shall become null and void and of no effect.

(2) If this Agreement is terminated with respect to a Settling State for whatever reason, then (A) the applicable statute of limitation or any similar time requirement shall be tolled from the date such Settling State signed this Agreement until the later of the time permitted by applicable law or for one year from the date of such termination, with the effect that the parties shall be in the same position with respect to the statute of limitation as they were at the time such Settling State filed its action, and (B) the parties shall jointly move the Court for an order reinstating the actions and claims dismissed pursuant to sections XIII and XIV hereof, with the effect that the parties shall be in the same position with respect to those actions and claims as they were at the time the action or claim was stayed or dismissed.

(v) Freedom of Information Requests. Upon the occurrence of State-Specific Finality in a Settling State, each Participating Manufacturer will withdraw in writing any and all requests for information, administrative applications, and proceedings brought or caused to be brought by such Participating Manufacturer pursuant to such Settling State's freedom of information law relating to the subject matter of the lawsuits identified in Exhibit D.

(w) Bankruptcy. The following provisions shall apply if a Participating Manufacturer both enters Bankruptcy and at any time thereafter is not timely performing its financial obligations as required under this Agreement:

(1) In the event that both a number of Settling States equal to at least 75% of the total number of Settling States and Settling States having aggregate Allocable Shares equal to at least 75% of the total aggregate Allocable Shares assigned to all Settling States deem (by written notice to the Participating Manufacturers other than the bankrupt Participating Manufacturer) that the financial obligations of this Agreement have been terminated and rendered null and void as to such bankrupt Participating Manufacturer (except as provided in subsection (A) below) due to a material breach by such Participating Manufacturer, whereupon, with respect to all Settling States:

(A) all agreements, all concessions, all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall be null and void as to such Participating Manufacturer. Provided, however, that (i) all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall remain in full force and effect as to all persons or entities (other than the bankrupt Participating Manufacturer itself or any person or entity that, as a result of the Bankruptcy, obtains domestic tobacco assets of such

Participating Manufacturer (unless such person or entity is itself a Participating Manufacturer)) who (but for the first sentence of this subsection (A)) would otherwise be Released Parties by virtue of their relationship with the bankrupt Participating Manufacturer; and (ii) in the event a Settling State asserts any Released Claim against a bankrupt Participating Manufacturer after the termination of this Agreement with respect to such Participating Manufacturer as described in this subsection (1) and receives a judgment, settlement or distribution arising from such Released Claim, then the amount of any payments such Settling State has previously received from such Participating Manufacturer under this Agreement shall be applied against the amount of any such judgment, settlement or distribution (provided that in no event shall such Settling State be required to refund any payments previously received from such Participating Manufacturer pursuant to this Agreement);

(B) the Settling States shall have the right to assert any and all claims against such Participating Manufacturer in the Bankruptcy or otherwise without regard to any limits otherwise provided in this Agreement (subject to any and all defenses against such claims);

(C) the Settling States may exercise all rights provided under the federal Bankruptcy Code (or other applicable bankruptcy law) with respect to their Claims against such Participating Manufacturer, including the right to initiate and complete police and regulatory actions against such Participating Manufacturer pursuant to the exceptions to the automatic stay set forth in section 362(b) of the Bankruptcy Code (provided, however, that such Participating Manufacturer may contest whether the Settling State's action constitutes a police and regulatory action); and

(D) to the extent that any Settling State is pursuing a police and regulatory action against such Participating Manufacturer as described in subsection (1)(C), such Participating Manufacturer shall not request or support a request that the Bankruptcy court utilize the authority provided under section 105 of the Bankruptcy Code to impose a discretionary stay on the Settling State's action. The Participating Manufacturers further agree that they will not request, seek or support relief from the terms of this Agreement in any proceeding before any court of law (including the federal bankruptcy courts) or an administrative agency or through legislative action, including (without limitation) by way of joinder in or consent to or acquiescence in any such pleading or instrument filed by another.

(2) Whether or not the Settling States exercise the option set forth in subsection (1) (and whether or not such option, if exercised, is valid and enforceable):

(A) In the event that the bankrupt Participating Manufacturer is an Original Participating Manufacturer, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as an Original Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), IX(d)(2) and IX(d)(3) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as an Original Participating Manufacturer for all other purposes with respect to such subsection); (iii) for purposes of subsection (B)(iii) of Exhibit E, such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer, but its operating income shall be recalculated by the Independent Auditor to reflect what such income would have been had such Participating Manufacturer made the payments that would have been due under this Agreement but for the Bankruptcy; (iv) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as an Original Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall continue to be treated as an Original Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection); and (v) as to any action that by the express terms of this Agreement requires the unanimous agreement of all Original Participating Manufacturers.

(B) In the event that the bankrupt Participating Manufacturer is a Subsequent Participating Manufacturer, such Participating Manufacturer shall continue to be treated as a Subsequent Participating Manufacturer for all purposes under this Agreement except (i) such Participating Manufacturer shall be treated as a Non-Participating Manufacturer (and not as a Subsequent Participating Manufacturer or Participating Manufacturer) for all purposes with respect to subsections IX(d)(1), (d)(2) and (d)(4) (including, but not limited to, that the Market Share of such Participating Manufacturer shall not be included in Base Aggregate Participating Manufacturer Market Share or Actual Aggregate Participating Manufacturer Market Share, and that such Participating Manufacturer's volume shall not be included for any purpose under subsection IX(d)(1)(D)); (ii) such Participating Manufacturer's Market Share shall not be included as that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(e) has been achieved (provided that such Participating Manufacturer shall be treated as a Subsequent Participating Manufacturer for all other purposes with respect to such subsection); and (iii) for purposes of subsection XVIII(c), such Participating Manufacturer shall not be treated as a Subsequent Participating Manufacturer or as a Participating Manufacturer to the extent that after entry into Bankruptcy it becomes the acquiror or transferee of Cigarette brands, Brand Names, Cigarette product formulas or Cigarette businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall

continue to be treated as a Subsequent Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection).

(C) Revision of this Agreement pursuant to subsection XVIII(b)(2) shall not be required by virtue of any resolution on an involuntary basis in the Bankruptcy of Claims against the bankrupt Participating Manufacturer.

(x) Notice of Material Transfers. Each Participating Manufacturer shall provide notice to each Settling State at least 20 days before consummating a sale, transfer of title or other disposition, in one transaction or series of related transactions, of assets having a fair market value equal to five percent or more (determined in accordance with United States generally accepted accounting principles) of the consolidated assets of such Participating Manufacturer.

(y) Entire Agreement. This Agreement (together with any agreements expressly contemplated hereby and any other contemporaneous written agreements) embodies the entire agreement and understanding between and among the Settling States and the Participating Manufacturers relating to the subject matter hereof and supersedes (1) all prior agreements and understandings relating to such subject matter, whether written or oral, and (2) all purportedly contemporaneous oral agreements and understandings relating to such subject matter.

(z) Business Days. Any obligation hereunder that, under the terms of this Agreement, is to be performed on a day that is not a Business Day shall be performed on the first Business Day thereafter.

(aa) Subsequent Signatories. With respect to a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, the timing of obligations under this Agreement (other than payment obligations, which shall be governed by subsection II(jj)) shall be negotiated to provide for the institution of such obligations on a schedule not more favorable to such subsequent signatory than that applicable to the Original Participating Manufacturers.

(bb) Decimal Places. Any figure or percentage referred to in this Agreement shall be carried to seven decimal places.

(cc) Regulatory Authority. Nothing in section III of this Agreement is intended to affect the legislative or regulatory authority of any local or State government.

(dd) Successors. In the event that a Participating Manufacturer ceases selling a brand of Tobacco Products in the States that such Participating Manufacturer owned in the States prior to July 1, 1998, and an Affiliate of such Participating Manufacturer thereafter and after the MSA Execution Date intentionally sells such brand in the States, such Affiliate shall be considered to be the successor of such Participating Manufacturer with respect to such brand. Performance by any such successor of the obligations under this Agreement with respect to the sales of such brand shall be subject to court-ordered specific performance.

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

EXHIBIT A
STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

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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

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

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

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

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

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

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

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

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

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-1. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. *Duties and Liabilities of Escrow Agent.*

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. *Indemnification of Escrow Agent.*

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. *Resignation of Escrow Agent.*

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to

be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. *Escrow Agent Fees and Expenses.*

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. *Notices.*

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. *Setoff; Reimbursement.*

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. *Intended Beneficiaries; Successors.*

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. *Governing Law.*

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. *Jurisdiction and Venue.*

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. *Amendments.*

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. *Counterparts.*

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement must promptly thereafter be delivered to each party.

SECTION 18. *Captions.*

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. *Conditions to Effectiveness.*

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments.*

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting.*

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A

Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING INFLATION ADJUSTMENTS

(1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.

(2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.

(3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.

(4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).

(5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).

(6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.

(7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):

-- the subsection IX(c)(1) base payment amount for 2002 of $6,500,000,000 as adjusted for inflation would equal $7,137,204,750;

-- the subsection IX(c)(1) base payment amount for 2004 of $8,000,000,000 as adjusted for inflation would equal $9,455,368,856;

-- the subsection IX(c)(1) base payment amount for 2006 of $8,000,000,000 as adjusted for inflation would equal $10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
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. 1JU-97915 CI (Alaska)

3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)

4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)

5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301

6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)

7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV96-0148414S (Conn.)

8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)

9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)

10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)

11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)

12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)

13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)

14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)

15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)

16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)

17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)

18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)

19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)

20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)

21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)

22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)

25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)

26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)

27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)

28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)

29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)

35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)

36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)

37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)

38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-1505608SEA (Wash.)

39. West Virginia
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-1707 (W. Va.)

40. Wisconsin
State of Wisconsin v. Philip Morris Inc., et al., Circuit Court, Branch 11, Dane County, No. 97-CV-328 (Wis.)

Additional States

For each Settling State not listed above, the lawsuit or other legal action filed by the Attorney General or Governor of such Settling State against *Participating* Manufacturers in the Court in such Settling State prior to 30 days after the MSA Execution Date asserting Released Claims.

EXHIBIT E
FORMULA FOR CALCULATING VOLUME ADJUSTMENTS

Any amount that by the terms of the Master Settlement Agreement is to be adjusted pursuant to this Exhibit E (the "Applicable Base Payment") shall be adjusted in the following manner:

(A) In the event the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufacturers in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than 475,656,000,000 Cigarettes (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume.

(B) In the event the Actual Volume is less than the Base Volume,

i. The Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (i) 1(one) minus (ii) the ratio of the Actual Volume to the Base Volume.

ii. Solely for purposes of calculating volume adjustments to the payments required under subsection IX(c)(1), if a reduction of the Base Payment due under such subsection results from the application of subparagraph (B)(i) of this Exhibit E, but the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes for the Applicable Year in the fifty United States, the District of Columbia, and Puerto Rico (the "Actual Operating Income") is greater than $7,195,340,000 (the "Base Operating Income") (such Base Operating Income being adjusted upward in accordance with the formula for inflation adjustments set forth in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996) then the amount by which such Base Payment is reduced by the application of subsection (B)(i) shall be reduced (but not below zero) by the amount calculated by multiplying (i) a percentage equal to the aggregate Allocable Shares of the Settling States in which State-Specific Finality has occurred by (ii) 25% of such increase in such operating income. For purposes of this Exhibit E, "operating income from sales of Cigarettes" shall mean operating income from sales of Cigarettes in the fifty United States, the District of Columbia, and Puerto Rico: (a) before goodwill amortization, trademark amortization, restructuring charges and restructuring related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes; and (b) excluding extraordinary items, cumulative effect of changes in method of accounting and discontinued operations -- all as such income is reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of such Participating Manufacturer) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by a nationally recognized accounting firm. For years subsequent to 1998, the determination of the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes shall not exclude any charges or expenses incurred or accrued in connection with this Agreement or any prior settlement of a tobacco and health case and shall otherwise be derived using the same principles as were employed in deriving such Original Participating Manufacturers' aggregate operating income from sales of Cigarettes in 1996.

iii. Any increase in a Base Payment pursuant to subsection (B)(ii) above shall be allocated among the Original Participating Manufacturers in the following manner:

(1) only to those Original Participating Manufacturers whose operating income from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico for the year for which the Base Payment is being adjusted is greater than their respective operating income from such sales of Cigarettes (including operating income from such sales of any of their Affiliates that do not continue to have such sales after the MSA Execution Date) in 1996 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996); and

(2) among the Original Participating Manufacturers described in paragraph (1) above in proportion to the ratio of (x) the increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of the Original Participating Manufacturer in question, to (y) the aggregate increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of those Original Participating Manufacturers described in paragraph (1) above.

(C) "Applicable Year" means the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) For purposes of this Exhibit, shipments shall be measured as provided in subsection II(mm).

EXHIBIT F
POTENTIAL LEGISLATION NOT TO BE OPPOSED

1. Limitations on Youth access to vending machines.
2. Inclusion of cigars within the definition of tobacco products.
3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
4. Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.
6. Enforcement of access restrictions through penalties on Youth for possession or use.
7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.

EXHIBIT G
OBLIGATIONS OF THE TOBACCO INSTITUTE UNDER THE MASTER SETTLEMENT AGREEMENT

(a) Upon court approval of a plan of dissolution The Tobacco Institute ("TI") will:

(1) Employees. Promptly notify and arrange for the termination of the employment of all employees; provided, however, that TI may continue to engage any employee who is (A) essential to the wind-down function as set forth in section (g) herein; (B) reasonably needed for the sole purpose of directing and supporting TI's defense of ongoing litigation; or (C) reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's (the "TITL") industry-wide cigarette testing pursuant to the Federal Trade Commission (the "FTC") method or any other testing prescribed by state or federal law as set forth in section (h) herein.

(2) Employee Benefits. Fund all employee benefit and pension programs; provided, however, that unless ERISA or other federal or state law prohibits it, such funding will be accomplished through periodic contributions by the Original Participating Manufacturers, according to their Relative Market Shares, into a trust or a like mechanism, which trust or like mechanism will be established within 90 days of court approval of the plan of dissolution. An opinion letter will be appended to the dissolution plan to certify that the trust plan is not inconsistent with ERISA or employee benefit pension contracts.

(3) Leases. Terminate all leaseholds at the earliest possible date pursuant to the leases; provided, however, that TI may retain or lease anew such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for subsequent litigation defense activities. Immediately upon execution of this Agreement, TI will provide notice to each of its landlords of its desire to terminate its lease with such landlord, and will request that the landlord take all steps to re-lease the premises at the earliest possible date consistent with TI's performance of its obligations hereunder. TI will vacate such leasehold premises as soon as they are re-leased or on the last day of wind-down, whichever occurs first.

(b) Assets/Debts. Within 60 days after court approval of a plan of dissolution, TI will provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, its debts, tax claims against it, claims of state and federal governments against it, creditor claims against it, pending litigation in which it is a party and notices of claims against it.

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ 91-99, TI will provide a copy of or otherwise make available to the State of New York all documents in its possession, excluding those that TI continues to claim to be subject to any attorney-client privilege, attorney work product protection, common interest/joint defense privilege or any other applicable privilege (collectively, "privilege") after the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County) (the "Oklahoma action"):

(1) TI will deliver to the Attorney General of the State of New York a copy of the privilege log served by it in the Oklahoma action. Upon a written request by the Attorney General, TI will deliver an updated version of its privilege log, if any such updated version exists.

(2) The disclosure of any document or documents claimed to be privileged will be governed by section IV of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI will provide a sworn affidavit that all documents in its possession have been made available to the Attorney General of New York except for documents claimed to be privileged, and that any privilege logs that already exist have been made available to the Attorney General.

(d) Remaining Assets. On mutual agreement between TI and the Attorney General of New York, a not-for-profit health or child welfare organization will be named as the beneficiary of any TI assets that remain after lawful transfers of assets and satisfaction of TI's employee benefit obligations and any other debts, liabilities or claims.

(e) Defense of Litigation. Pursuant to Section 1006 of the New York Not-for-Profit Corporations Law, TI will have the right to continue to defend its litigation interests with respect to any claims against it that are pending or threatened now or that are brought or threatened in the future. TI will retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, having privileged communications and creating privileged documents, filing pleadings, responding to discovery requests, making motions, filing affidavits and briefs, conducting party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending itself at trial, settling any claims asserted against it, intervening or otherwise participating in litigation to protect interests that it deems significant to its defense, and otherwise directing or conducting its defense. Pursuant to existing joint defense agreements, TI may continue to assist its current or former members in defense of any litigation brought or threatened against them. TI also may enter into any new joint defense agreement or agreements that it deems significant to its defense of pending or threatened claims. TI may continue to engage such employees as reasonably needed for the sole purpose of directing and supporting its defense of ongoing litigation. As soon as TI has no litigation pending against it, it will dissolve completely and will cease all functions consistent with the requirements of law.

(f) No public statement. Except as necessary in the course of litigation defense as set forth in section (e) above, upon court approval of a plan of dissolution, neither TI nor any of its employees or agents acting in their official capacity on behalf of TI will issue any statements, press releases, or other public statement concerning tobacco.

(g) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than its defense of litigation as described in section (e) above) expeditiously, and in no event later than 180 days after the date of court approval of the plan of dissolution. TI will provide monthly status reports to the Attorney General of New York regarding the progress of wind-down efforts and work remaining to be done with respect to such efforts.

(h) TITL. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform TITL industry-wide cigarette testing pursuant to the FTC method or any other testing prescribed by state or federal law until such function is transferred to another entity, which transfer will be accomplished as soon as practicable but in no event more than 180 days after court approval of the dissolution plan.

(i) Jurisdiction. After the filing of a Certificate of Dissolution, pursuant to Section 1004 of the New York Not-for-Profit Corporation Law, the Supreme Court for the State of New York will have continuing jurisdiction over the dissolution of TI and the winding-down of TI's activities, including any litigation-related activities described in subsection (e) herein.

(j) No Determination or Admission. The dissolution of TI and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, deemed to be, or represented or caused to be represented by any Settling State as, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of TI, any of its current or former members or anyone acting on their behalf. TI specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States.

(k) Court Approval. The Attorney General of the State of New York and the Original Participating Manufacturers will prepare a joint plan of dissolution for submission to the Supreme Court of the State of New York, all of the terms of which will be agreed on and consented to by the Attorney General and the Original Participating Manufacturers consistent with this schedule. The Original Participating Manufacturers and their employees, as officers and directors of TI, will take whatever steps are necessary to execute all documents needed to develop such a plan of dissolution and to submit it to the court for approval. If any court makes any material change to any term or provision of the plan of dissolution agreed upon and consented to by the Attorney General and the Original Participating Manufacturers, then:

(1) the Original Participating Manufacturers may, at their election, nevertheless proceed with the dissolution plan as modified by the court; or

(2) if the Original Participating Manufacturers elect not to proceed with the court-modified dissolution plan, the Original Participating Manufacturers will be released from any obligations or undertakings under this Agreement or this schedule with respect to TI; provided, however, that the Original Participating Manufacturers will engage in good faith negotiations with the New York Attorney General to agree upon the term or terms of the dissolution plan that the court may have modified in an effort to agree upon a dissolution plan that may be resubmitted for the court's consideration.

EXHIBIT H
DOCUMENT PRODUCTION

Section 1.

(a) Philip Morris Companies, Inc., et al., v. American Broadcasting Companies, Inc., et al., At Law No. 760CL94X00816-00 (Cir. Ct., City of Richmond)

(b) Harley-Davidson v. Lorillard Tobacco Co., No. 93-947 (S.D.N.Y.)

(c) Lorillard Tobacco Co. v. Harley-Davidson, No. 93-6098 (E.D. Wis.)

(d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-648 (N.D. Ill.)

(e) The FTC investigations of tobacco industry advertising and promotion as embodied in the following cites:

46 FTC 706
48 FTC 82
46 FTC 735
47 FTC 1393
108 F. Supp. 573
55 FTC 354
56 FTC 96
79 FTC 255
80 FTC 455
Investigation #8023069
Investigation #8323222

Each Original Participating Manufacturer and Tobacco-Related Organization will conduct its own reasonable inquiry to determine what documents or deposition testimony, if any, it produced or provided in the above-listed matters.

Section 2.

(a) State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King)

(b) In re Mike Moore, Attorney General, ex rel. State of Mississippi Tobacco Litigation, No. 94-1429 (Chancery Ct., Jackson, Miss.)

(c) State of Florida v. American Tobacco Co., et al., No. CL 95-1466 AH (Fla. Cir. Ct., 15th Judicial Cir., Palm Beach Co.)

(d) State of Texas v. American Tobacco Co., et al., No. 5-96CV-91 (E.D. Tex.)

(e) Minnesota v. Philip Morris et al., No. C-94-8565 (Minn. Dist. Ct., County of Ramsey)

(f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (11th Judicial Ct., Dade County, Florida)

EXHIBIT I
INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE

(a) Each Original Participating Manufacturer and Tobacco-Related Organization will create and maintain on its website, at its expense, an enhanced, searchable index, as described below, using Alta-Vista or functionally comparable software, for all of the documents currently on its website and all documents being placed on its website pursuant to section IV of this Agreement.

(b) The searchable indices of documents on these websites will include:

(1) all of the information contained in the 4(b) indices produced to the State Attorneys General (excluding fields specific only to the Minnesota action other than "request number");

(2) the following additional fields of information (or their substantial equivalent) to the extent such information already exists in an electronic format that can be incorporated into such an index:

Document ID	Master ID
Other Number	Document Date
Primary Type	Other Type
Person Attending	Person Noted
Person Author	Person Recipient
Person Copied	Person Mentioned
Organization Author	Organization Recipient
Organization Copied	Organization Mentioned
Organization Attending	Organization Noted
Physical Attachment 1	Physical Attachment 2
Characteristics	File Name
Site	Area
Verbatim Title	Old Brand
Primary Brand	Mentioned Brand
Page Count	

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(h) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the

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

Section 9

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

Section 10

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

Section 11

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

Section 12

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

Section 13

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

Section C
Grant Application Procedures

Section 1

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

Section 2

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

Section 3

Grant Applications must include the following:

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

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

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

(D) The amount requested.

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

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

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

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

Section 4

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

Section 5

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

Section D
Other Disbursements from the Fund

Section 1

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

Section E
Administrative Costs

Section 1

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

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

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

EXHIBIT L
MODEL CONSENT DECREE

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

-------------------------------- x CAUSE NO. XXXXXX

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

CONSENT DECREE AND FINAL JUDGMENT

-------------------------------- x

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

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

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

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

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

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

I. JURISDICTION AND VENUE

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

II. DEFINITIONS

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

III. APPLICABILITY

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

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

IV. VOLUNTARY ACT OF THE PARTIES

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

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

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

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

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

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

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

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

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

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

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

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

VI. MISCELLANEOUS PROVISIONS

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

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

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

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

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

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

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

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

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

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

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

VII. FINAL DISPOSITION

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

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

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____ day of _____________, 1998.

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

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

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

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

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

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-ev-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96

2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. I 1997/359

3. County of Los Angeles v. R.J. Reynolds Tobacco Co. et al., San Diego Superior Court, No. 707651

4. The People v. Philip Morris, Inc. et al., San Francisco Superior Court, No. 980864

5. County of Cook v. Philip Morris, Inc. et al., Circuit Court of Cook County, Ill., No. 97-L-4550

EXHIBIT O
MODEL STATE FEE PAYMENT AGREEMENT

This STATE Fee Payment Agreement (the "STATE Fee Payment Agreement") is entered into as of ________, _____ between and among the Original Participating Manufacturers and STATE Outside Counsel (as defined herein), to provide for payment of attorneys' fees pursuant to Section XVII of the Master Settlement Agreement (the "Agreement").

WITNESSETH:

WHEREAS, the State of STATE and the Original Participating Manufacturers have entered into the Agreement to settle and resolve with finality all Released Claims against the Released Parties, including the Original Participating Manufacturers, as set forth in the Agreement; and

WHEREAS, Section XVII of the Agreement provides that the Original Participating Manufacturers shall pay reasonable attorneys' fees to those private outside counsel identified in Exhibit S to the Agreement, pursuant to the terms hereof;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the mutual agreement of the State of STATE and the Original Participating Manufacturers to the terms of the Agreement and of the mutual agreement of STATE Outside Counsel and the Original Participating Manufacturers to the terms of this STATE Fee Payment Agreement, and such other consideration described herein, the Original Participating Manufacturers and STATE Outside Counsel agree as follows:

SECTION 1. *Definitions.*

All definitions contained in the Agreement are incorporated by reference herein, except as to terms specifically defined herein.

(a) *"Action"* means the lawsuit identified in Exhibit D, M or N to the Agreement that has been brought by or against the State of STATE [or Litigating Political Subdivision].

(b) *"Allocated Amount"* means the amount of any Applicable Quarterly Payment allocated to any Private Counsel (including STATE Outside Counsel) pursuant to section 17 hereof.

(c) *"Allocable Liquidated Share"* means, in the event that the sum of all Payable Liquidated Fees of Private Counsel as of any date specified in section 8 hereof exceeds the Applicable Liquidation Amount for any payment described therein, a percentage share of the Applicable Liquidation Amount equal to the proportion of (i) the amount of the Payable Liquidated Fee of STATE Outside Counsel to (ii) the sum of Payable Liquidated Fees of all Private Counsel.

(d) *"Applicable Liquidation Amount"* means, for purposes of the payments described in section 8 hereof —

(i) for the payment described in subsection (a) thereof, $125 million;

(ii) for the payment described in subsection (b) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsection (a) thereof;

(iii) for the payment described in subsection (c) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a) and (b) thereof;

(iv) for the payment described in subsection (d) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b) and (c) thereof;

(v) for the payment described in subsection (e) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b), (c) and (d) thereof;

(vi) for each of the first, second and third quarterly payments for any calendar year described in subsection (f) thereof, $62.5 million; and

(vii) for each of the fourth calendar quarterly payments for any calendar year described in subsection (f) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel with respect to the preceding calendar quarters of the calendar year.

(e) *"Application"* means a written application for a Fee Award submitted to the Panel, as well as all supporting materials (which may include video recordings of interviews).

(f) *"Approved Cost Statement"* means both (i) a Cost Statement that has been accepted by the Original Participating Manufacturers; and (ii) in the event that a Cost Statement submitted by STATE Outside Counsel is disputed, the determination by arbitration pursuant to subsection (b) of section 19 hereof as to the amount of the reasonable costs and expenses of STATE Outside Counsel.

(g) *"Cost Statement"* means a signed and attested statement of reasonable costs and expenses of Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision.

(h) "*Designated Representative*" means the person designated in writing, by each person or entity identified in Exhibit S to the Agreement [by the Attorney General of the State of STATE or as later certified in writing by the governmental prosecuting authority of the Litigating Political Subdivision], to act as their agent in receiving payments from the Original Participating Manufacturers for the benefit of STATE Outside Counsel pursuant to sections 8, 16 and 19 hereof, as applicable.

(i) "*Director*" means the Director of the Private Adjudication Center of the Duke University School of Law or such other person or entity as may be chosen by agreement of the Original Participating Manufacturers and the Committee described in the second sentence of paragraph (b)(ii) of section 11 hereof.

(j) "*Eligible Counsel*" means Private Counsel eligible to be allocated a part of a Quarterly Fee Amount pursuant to section 17 hereof.

(k) "*Federal Legislation*" means federal legislation that imposes an enforceable obligation on Participating Defendants to pay attorneys' fees with respect to Private Counsel.

(l) "*Fee Award*" means any award of attorneys' fees by the Panel in connection with a Tobacco Case.

(m) "*Liquidated Fee*" means an attorneys' fee for Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision, in an amount agreed upon by the Original Participating Manufacturers and such Outside Counsel.

(n) "*Outside Counsel*" means all those Private Counsel identified in Exhibit S to the Agreement.

(o) "*Panel*" means the three-member arbitration panel described in section 11 hereof.

(p) "*Party*" means (i) STATE Outside Counsel and (ii) an Original Participating Manufacturer.

(q) "*Payable Cost Statement*" means the unpaid amount of a Cost Statement as to which all conditions precedent to payment have been satisfied.

(r) "*Payable Liquidated Fee*" means the unpaid amount of a Liquidated Fee as to which all conditions precedent to payment have been satisfied.

(s) "*Previously Settled States*" means the States of Mississippi, Florida and Texas.

(t) "*Private Counsel*" means all private counsel for all plaintiffs in a Tobacco Case (including STATE Outside Counsel).

(u) "*Quarterly Fee Amount*" means, for purposes of the quarterly payments described in sections 16, 17 and 18 hereof —

(i) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 1999 and ending with the third calendar quarter of 2008, $125 million;

(ii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 1999 and ending with the fourth calendar quarter of 2003, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any;

(iii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2004 and ending with the fourth calendar quarter of 2008, the sum of (A) $125 million; (B) the difference between (*1*) $375 million; and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any; and (C) the difference, if any, between (*1*) $250 million and (*2*) the product of (*a*) .2 (two tenths) and (*b*) the sum of all amounts paid in satisfaction of all Liquidated Fees of Outside Counsel pursuant to section 8 hereof, if any;

(iv) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 2009, $125 million; and

(v) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2009, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any.

(v) "*Related Persons*" means each Original Participating Manufacturer's past, present and future Affiliates, divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing).

(w) "*State of STATE*" means the [applicable Settling State or the Litigating Political Subdivision], any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and subdivisions.

(x) "*STATE Outside Counsel*" means all persons or entities identified in Exhibit S to the Agreement by the Attorney General of State of STATE [or as later certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] as having been retained by and having represented the STATE in connection with the Action, acting collectively by unanimous decision of all such persons or entities.

(y) "*Tobacco Case*" means any tobacco and health case (other than a non-class action personal injury case brought directly by or on behalf of a single natural person or the survivor of such person or for wrongful death, or any non-class action consolidation of two or more such cases).

(z) "*Unpaid Fee*" means the unpaid portion of a Fee Award.

SECTION 2. *Agreement to Pay Fees.*

The Original Participating Manufacturers will pay reasonable attorneys' fees to STATE Outside Counsel for their representation of the State of STATE in connection with the Action, as provided herein and subject to the *Code of Professional Responsibility* of the American Bar Association. Nothing herein shall be construed to require the Original Participating Manufacturers to pay any attorneys' fees other than (i) a Liquidated Fee or a Fee Award and (ii) a Cost Statement, as provided herein, nor shall anything herein require the Original Participating Manufacturers to pay any Liquidated Fee, Fee Award or Cost Statement in connection with any litigation other than the Action.

SECTION 3. *Exclusive Obligation of the Original Participating Manufacturers.*

The provisions set forth herein constitute the entire obligation of the Original Participating Manufacturers with respect to payment of attorneys' fees of STATE Outside Counsel (including costs and expenses) in connection with the Action and the exclusive means by which STATE Outside Counsel or any other person or entity may seek payment of fees by the Original Participating Manufacturers or Related Persons in connection with the Action. The Original Participating Manufacturers shall have no obligation pursuant to Section XVII of the Agreement to pay attorneys' fees in connection with the Action to any counsel other than STATE Outside Counsel, and they shall have no other obligation to pay attorneys' fees to or otherwise to compensate STATE Outside Counsel, any other counsel or representative of the State of STATE or the State of STATE itself with respect to attorneys' fees in connection with the Action.

SECTION 4. *Release.*

(a) Each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] hereby irrevocably releases the Original Participating Manufacturers and all Related Persons from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

(b) In the event that STATE Outside Counsel and the Original Participating Manufacturers agree upon a Liquidated Fee pursuant to section 7 hereof, it shall be a precondition to any payment by the Original Participating Manufacturers to the Designated Representative pursuant to section 8 hereof that each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] shall have irrevocably released all entities represented by STATE Outside Counsel in the Action, as well as all persons acting by or on behalf of such entities (including the Attorney General [or the office of the governmental prosecuting authority] and each other person or entity identified on Exhibit S to the Agreement by the Attorney General [or the office of the governmental prosecuting authority]) from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

SECTION 5. *No Effect on STATE Outside Counsel's Fee Contract.*

The rights and obligations, if any, of the respective parties to any contract between the State of STATE and STATE Outside Counsel shall be unaffected by this STATE Fee Payment Agreement except (a) insofar as STATE Outside Counsel grant the release described in subsection (b) of section 4 hereof; and (b) to the extent that STATE Outside Counsel receive any payments in satisfaction of a Fee Award pursuant to section 16 hereof, any amounts so received shall be credited, on a dollar-for-dollar basis, against any amount payable to STATE Outside Counsel by the State of STATE [or the Litigating Political Subdivision] under any such contract.

SECTION 6. *Liquidated Fees.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel agree upon the amount of a Liquidated Fee, the Original Participating Manufacturers shall pay such Liquidated Fee, pursuant to the terms hereof.

(b) The Original Participating Manufacturers' payment of any Liquidated Fee pursuant to this STATE Fee Payment Agreement shall be subject to (i) satisfaction of the conditions precedent stated in section 4 and paragraph (c)(ii) of section 7 hereof; and (ii) the payment schedule and the annual and quarterly aggregate national caps specified in sections 8 and 9 hereof, which shall apply to all payments made with respect to Liquidated Fees of all Outside Counsel.

SECTION 7. *Negotiation of Liquidated Fees.*

(a) If STATE Outside Counsel seek to be paid a Liquidated Fee, the Designated Representative shall so notify the Original Participating Manufacturers. The Original Participating Manufacturers may at any time make an offer of a Liquidated Fee to the Designated Representative in an amount set by the unanimous agreement, and at the sole discretion, of the Original Participating Manufacturers and, in any event, shall collectively make such an offer to the Designated Representative no more than 60 Business Days after receipt of notice by the Designated Representative that STATE Outside

Counsel seek to be paid a Liquidated Fee. The Original Participating Manufacturers shall not be obligated to make an offer of a Liquidated Fee in any particular amount. Within ten Business Days after receiving such an offer, STATE Outside Counsel shall either accept the offer, reject the offer or make a counteroffer.

(b) The national aggregate of all Liquidated Fees to be agreed to by the Original Participating Manufacturers in connection with the settlement of those actions indicated on Exhibits D, M and N to the Agreement shall not exceed one billion two hundred fifty million dollars ($1,250,000,000).

(c) If the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee:

(i) STATE Outside Counsel shall not be eligible for a Fee Award;

(ii) such Liquidated Fee shall not become a Payable Liquidated Fee until such time as (A) State-Specific Finality has occurred in the State of STATE; (B) each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority of the Litigating Political Subdivision] has granted the release described in subsection (b) of section 4 hereof; and (C) notice of the events described in subparagraphs (A) and (B) of this paragraph has been provided to the Original Participating Manufacturers.

(iii) payment of such Liquidated Fee pursuant to sections 8 and 9 hereof (together with payment of costs and expenses pursuant to section 19 hereof), shall be STATE Outside Counsel's total and sole compensation by the Original Participating Manufacturers in connection with the Action.

(d) If the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee, STATE Outside Counsel may submit an Application to the Panel for a Fee Award to be paid as provided in sections 16, 17 and 18 hereof.

SECTION 8. *Payment of Liquidated Fee.*

In the event that the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee, and until such time as the Designated Representative has received payments in full satisfaction of such Liquidated Fee —

(a) On February 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before January 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of January 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(b) On August 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after January 15, 1999 and before July 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after January 15, 1999 and before July 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(c) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after July 15, 1999 and before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after July 15, 1999 and before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(d) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, or (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that become Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(e) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(f) On the last day of each calendar quarter, beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee at least 15 Business Days prior to the last day of each such calendar quarter, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of the date 15 Business Days prior to the date of the payment in question exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

SECTION 9. *Limitations on Payments of Liquidated Fees.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Liquidated Fees shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make any payment that would result in aggregate national payments of Liquidated Fees:

(i) during 1999, totaling more than $250 million;

(ii) with respect to any calendar quarter beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, totaling more than $62.5 million, except to the extent that a payment with respect to any prior calendar quarter of any calendar year did not total $62.5 million; or

(iii) with respect to any calendar quarter after the fourth calendar quarter of 2003, totaling more than zero.

(b) The Original Participating Manufacturers' obligations with respect to the Liquidated Fee of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Liquidated Fee shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 10. *Fee Awards.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee as described in section 7 hereof, the Original Participating Manufacturers shall pay, pursuant to the terms hereof, the Fee Award awarded by the Panel to STATE Outside Counsel.

(b) The Original Participating Manufacturers' payment of any Fee Award pursuant to this STATE Fee Payment Agreement shall be subject to the payment schedule and the annual and quarterly aggregate national caps specified in sections 17 and 18 hereof, which shall apply to:

(i) all payments of Fee Awards in connection with an agreement to pay fees as part of the settlement of any Tobacco Case on terms that provide for payment by the Original Participating Manufacturers or other defendants acting in agreement with the Original Participating Manufacturers (collectively, "Participating Defendants") of fees with respect to any Private Counsel, subject to an annual cap on payment of all such fees; and

(ii) all payments of attorneys' fees (other than fees for attorneys of Participating Defendants) pursuant to Fee Awards for activities in connection with any Tobacco Case resolved by operation of Federal Legislation.

SECTION 11. *Composition of the Panel.*

(a) The first and the second members of the Panel shall both be permanent members of the Panel and, as such, will participate in the determination of all Fee Awards. The third Panel member shall not be a permanent Panel member, but instead shall be a state-specific member selected to determine Fee Awards on behalf of Private Counsel retained in connection with litigation within a single state. Accordingly, the third, state-specific member of the Panel for purposes of determining Fee Awards with respect to litigation in the State of STATE shall not participate in any determination as to any Fee Award with respect to litigation in any other state (unless selected to participate in such determinations by such persons as may be authorized to make such selections under other agreements).

(b) The members of the Panel shall be selected as follows:

(i) The first member shall be the natural person selected by Participating Defendants.

(ii) The second member shall be the person jointly selected by the agreement of Participating Defendants and a majority of the committee described in the fee payment agreements entered in connection with the settlements of the Tobacco Cases brought by the Previously Settled States. In the event that the person so selected is unable or unwilling to continue to serve, a replacement for such member shall be selected by agreement of the Original Participating Manufacturers and a majority of the members of a committee composed of the following members: Joseph F. Rice, Richard F. Scruggs, Steven W. Berman, Walter Umphrey, one additional representative, to be selected in the sole discretion of NAAG, and two representatives of Private Counsel in Tobacco Cases, to be selected at the sole discretion of the Original Participating Manufacturers.

(iii) The third, state-specific member for purposes of determining Fee Awards with respect to litigation in the State of STATE shall be a natural person selected by STATE Outside Counsel, who shall notify the Director and the Original Participating Manufacturers of the name of the person selected.

SECTION 12. *Application of STATE Outside Counsel.*

(a) STATE Outside Counsel shall make a collective Application for a single Fee Award, which shall be submitted to the Director. Within five Business Days after receipt of the Application by STATE Outside Counsel, the Director shall serve the Application upon the Original Participating Manufacturers and the STATE. The Original Participating Manufacturers shall submit all materials in response to the Application to the Director by the later of (i) 60 Business Days after service of the Application upon the Original Participating Manufacturers by the Director, (ii) five Business Days after the date of State-Specific Finality in the State of STATE or (iii) five Business Days after the date on which notice of the name of the third, state-specific panel member described in paragraph (b)(iii) of section 11 hereof has been provided to the Director and the Original Participating Manufacturers.

(b) The Original Participating Manufacturers may submit to the Director any materials that they wish and, notwithstanding any restrictions or representations made in any other agreements, the Original Participating Manufacturers shall be in no way constrained from contesting the amount of the Fee Award requested by STATE Outside Counsel. The Director, the Panel, the State of STATE, the Original Participating Manufacturers and STATE Outside Counsel shall preserve the confidentiality of any attorney work-product materials or other similar confidential information that may be submitted.

(c) The Director shall forward the Application of STATE Outside Counsel, as well as all written materials relating to such Application that have been submitted by the Original Participating Manufacturers pursuant to subsection (b) of this section, to the Panel within five Business Days after the later of (i) the expiration of the period for the Original Participating Manufacturers to submit such materials or (ii) the earlier of (A) the date on which the Panel issues a Fee Award with respect to any Application of other Private Counsel previously forwarded to the Panel by the Director or (B) 30 Business Days after the forwarding to the Panel of the Application of other Private Counsel most recently forwarded to the Panel by the Director. The Director shall notify the Parties upon forwarding the Application (and all written materials relating thereto) to the Panel.

(d) In the event that either Party seeks a hearing before the Panel, such Party may submit a request to the Director in writing within five Business Days after the forwarding of the Application of STATE Outside Counsel to the Panel by the Director, and the Director shall promptly forward the request to the Panel. If the Panel grants the request, it shall promptly set a date for hearing, such date to fall within 30 Business Days after the date of the Panel's receipt of the Application.

SECTION 13. *Panel Proceedings.*

The proceedings of the Panel shall be conducted subject to the terms of this Agreement and of the Protocol of Panel Procedures attached as an Appendix hereto.

SECTION 14. *Award of Fees to STATE Outside Counsel.*

The members of the Panel will consider all relevant information submitted to them in reaching a decision as to a Fee Award that fairly provides for full reasonable compensation of STATE Outside Counsel. In considering the amount of the Fee Award, the Panel shall not consider any Liquidated Fee agreed to by any other Outside Counsel, any offer of or negotiations relating to any proposed liquidated fee for STATE Outside Counsel or any Fee Award that already has been or yet may be awarded in connection with any other Tobacco Case. The Panel shall not be limited to an hourly-rate or lodestar analysis in determining the amount of the Fee Award of STATE Outside Counsel, but shall take into account the totality of the circumstances. The Panel's decisions as to the Fee Award of STATE Outside Counsel shall be in writing and shall report the amount of the fee awarded (with or without explanation or opinion, at the Panel's discretion). The Panel shall determine the amount of the Fee Award to be paid to STATE Outside Counsel within the later of 30 calendar days after receiving the Application (and all related materials) from the Director or 15 Business Days after the last date of any hearing held pursuant to subsection (d) of section 12 hereof. The Panel's decision as to the Fee Award of STATE Outside Counsel shall be final, binding and non-appealable.

SECTION 15. *Costs of Arbitration.*

All costs and expenses of the arbitration proceedings held by the Panel, including costs, expenses and compensation of the Director and of the Panel members (but not including any costs, expenses or compensation of counsel making applications to the Panel), shall be borne by the Original Participating Manufacturers in proportion to their Relative Market Shares.

SECTION 16. *Payment of Fee Award of STATE Outside Counsel.*

On or before the tenth Business Day after the last day of each calendar quarter beginning with the first calendar quarter of 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Allocated Amount for STATE Outside Counsel for the calendar quarter with respect to which such quarterly payment is being made (the "Applicable Quarter").

SECTION 17. *Allocated Amounts of Fee Awards.*

The Allocated Amount for each Private Counsel with respect to any payment to be made for any particular Applicable Quarter shall be determined as follows:

(a) The Quarterly Fee Amount shall be allocated equally among each of the three months of the Applicable Quarter. The amount for each such month shall be allocated among those Private Counsel retained in connection with Tobacco Cases settled before or during such month (each such Private Counsel being an "Eligible Counsel" with respect to such monthly amount), each of which shall be allocated a portion of each such monthly amount up to (or, in the event that the sum of all Eligible Counsel's respective Unpaid Fees exceeds such monthly amount, in proportion to) the amount of such Eligible Counsel's Unpaid Fees. The monthly amount for each month of the calendar quarter shall be allocated among those Eligible Counsel having Unpaid Fees, without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter. The allocation of subsequent Quarterly Fee Amounts for the calendar year, if any, shall be adjusted, as necessary, to account for any Eligible Counsel that are granted Fee Awards in a subsequent quarter of such calendar year, as provided in paragraph (b)(ii) of this section.

(b) In the event that the amount for a given month is less than the sum of the Unpaid Fees of all Eligible Counsel:

(i) in the case of the first quarterly allocation for any calendar year, such monthly amount shall be allocated among all Eligible Counsel for such month in proportion to the amounts of their respective Unpaid Fees.

(ii) in the case of a quarterly allocation after the first quarterly allocation, the Quarterly Fee Amount shall be allocated among only those Private Counsel, if any, that were Eligible Counsel with respect to any monthly amount for any prior quarter of the calendar year but were not allocated a proportionate share of such monthly amount (either because such Private Counsel's applications for Fee Awards were still under consideration as of the last day of the calendar quarter containing the month in question or for any other reason), until each such Eligible Counsel has been allocated a proportionate share of all such prior monthly payments for the calendar year (each such share of each such Eligible Counsel being a "Payable Proportionate Share"). In the event that the sum of all Payable Proportionate Shares exceeds the Quarterly Fee Amount, the Quarterly Fee Amount shall be allocated among such Eligible Counsel on a monthly basis in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be other Eligible Counsel with respect to such prior monthly amounts that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter). In the event that the sum of all Payable Proportionate Shares is less than the Quarterly Fee Amount, the amount by which the Quarterly Fee Amount exceeds the sum of all such Payable Proportionate Shares shall be allocated among each month of the calendar quarter, each such monthly amount to be allocated among those Eligible Counsel having Unpaid Fees in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter).

(c) Adjustments pursuant to subsection (b)(ii) of this section 17 shall be made separately for each calendar year. No amounts paid in any calendar year shall be subject to refund, nor shall any payment in any given calendar year affect the allocation of payments to be made in any subsequent calendar year.

SECTION 18. *Credits to and Limitations on Payment of Fee Awards.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Fee Awards shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments and credits by Participating Defendants with respect to all Fee Awards of Private Counsel:

(i) during any year beginning with 1999, totaling more than the sum of the Quarterly Fee Amounts for each calendar quarter of the calendar year, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999; and

(ii) during any calendar quarter beginning with the first calendar quarter of 1999, totaling more than the Quarterly Fee Amount for such quarter, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999.

(b) The Original Participating Manufacturers' obligations with respect to the Fee Award of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Fee Award shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 19. *Reimbursement of Outside Counsel's Costs.*

(a) The Original Participating Manufacturers shall reimburse STATE Outside Counsel for reasonable costs and expenses incurred in connection with the Action, provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers ordinarily reimburse their own counsel or agents. Payment of any Approved Cost Statement pursuant to this STATE Fee Payment Agreement shall be subject to (i) the condition precedent of approval of the Agreement by the Court for the State of STATE and (ii) the payment schedule and the aggregate national caps specified in subsection (c) of this section, which shall apply to all payments made with respect to Cost Statements of all Outside Counsel.

(b) In the event that STATE Outside Counsel seek to be reimbursed for reasonable costs and expenses incurred in connection with the Action, the Designated Representative shall submit a Cost Statement to the Original Participating Manufacturers. Within 30 Business Days after receipt of any such Cost Statement, the Original Participating Manufacturers shall either accept the Cost Statement or dispute the Cost Statement, in which event the Cost Statement shall be subject to a full audit by examiners to be appointed by the Original Participating Manufacturers (in their sole discretion). Any such audit will be completed within 120 Business Days after the date the Cost Statement is received by the Original Participating Manufacturers. Upon completion of such audit, if the Original Participating Manufacturers and STATE Outside Counsel cannot agree as to the appropriate amount of STATE Outside Counsel's reasonable costs and expenses, the Cost Statement and the examiner's audit report shall be submitted to the Director for arbitration before the Panel or, in the event that STATE Outside Counsel and the Original Participating Manufacturers have agreed upon a Liquidated Fee pursuant to section 7 hereof, before a separate three-member panel of independent arbitrators, to be selected in a manner to be agreed to by STATE Outside Counsel and the Original Participating Manufacturers, which shall determine the amount of STATE Outside Counsel's reasonable costs and expenses for the Action. In determining such reasonable costs and expenses, the members of the arbitration panel shall be governed by the Protocol of Panel Procedures attached as an Appendix hereto. The amount of

STATE Outside Counsel's reasonable costs and expenses determined pursuant to arbitration as provided in the preceding sentence shall be final, binding and non-appealable.

(c) Any Approved Cost Statement of STATE Outside Counsel shall not become a Payable Cost Statement until approval of the Agreement by the Court for the State of STATE. Within five Business Days after receipt of notification thereof by the Designated Representative, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Payable Cost Statement of STATE Outside Counsel, subject to the following:

(i) All Payable Cost Statements of Outside Counsel shall be paid in the order in which such Payable Cost Statements became Payable Cost Statements.

(ii) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments by Participating Defendants of all Payable Cost Statements of Private Counsel in connection with all of the actions identified in Exhibits D, M and N to the Agreement, totaling more than $75 million for any given year.

(iii) Any Payable Cost Statement of Outside Counsel not paid during the year in which it became a Payable Cost Statement as a result of paragraph (ii) of this subsection shall become payable in subsequent years, subject to paragraphs (i) and (ii), until paid in full.

(d) The Original Participating Manufacturers' obligations with respect to reasonable costs and expenses incurred by STATE Outside Counsel in connection with the Action shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, any Approved Cost Statement determined pursuant to subsection (b) of this section (including any Approved Cost Statement determined pursuant to arbitration before the Panel or the separate three-member panel of independent arbitrators described therein) shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other incumbrance.

SECTION 20. *Distribution of Payments among STATE Outside Counsel.*

(a) All payments made to the Designated Representative pursuant to this STATE Fee Payment Agreement shall be for the benefit of each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], each of which shall receive from the Designated Representative a percentage of each such payment in accordance with the fee sharing agreement, if any, among STATE Outside Counsel (or any written amendment thereto).

(b) The Original Participating Manufacturers shall have no obligation, responsibility or liability with respect to the allocation among those persons or entities identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], or with respect to any claim of misallocation, of any amounts paid to the Designated Representative pursuant to this STATE Fee Payment Agreement.

SECTION 21. *Calculations of Amounts.*

All calculations that may be required hereunder shall be performed by the Original Participating Manufacturers, with notice of the results thereof to be given promptly to the Designated Representative. Any disputes as to the correctness of calculations made by the Original Participating Manufacturers shall be resolved pursuant to the procedures described in Section XI(c) of the Agreement for resolving disputes as to calculations by the Independent Auditor.

SECTION 22. *Payment Responsibility.*

(a) Each Original Participating Manufacturer shall be severally liable for its share of all payments pursuant to this STATE Fee Payment Agreement. Under no circumstances shall any payment due hereunder or any portion thereof become the joint obligation of the Original Participating Manufacturers or the obligation of any person other than the Original Participating Manufacturer from which such payment is originally due, nor shall any Original Participating Manufacturer be required to pay a portion of any such payment greater than its Relative Market Share.

(b) Due to the particular corporate structures of R. J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("Brown & Williamson") with respect to their non-domestic tobacco operations, Reynolds and Brown & Williamson shall each be severally liable for its respective share of each payment due pursuant to this STATE Fee Payment Agreement up to (and its liability hereunder shall not exceed) the full extent of its assets used in, and earnings and revenues derived from, its manufacture and sale in the United States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of its other assets or earnings to satisfy such obligations.

SECTION 23. *Termination.*

In the event that the Agreement is terminated with respect to the State of STATE pursuant to Section XVIII(u) of the Agreement (or for any other reason) the Designated Representative and each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision] shall immediately refund to the Original Participating Manufacturers all amounts received under this STATE Fee Payment Agreement.

SECTION 24. *Intended Beneficiaries.*

No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the State of STATE. Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.

SECTION 25. *Representations of Parties.*

The Parties hereto hereby represent that this STATE Fee Payment Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the Parties hereto.

SECTION 26. *No Admission.*

This STATE Fee Payment Agreement is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or wrongdoing whatsoever on the part of any signatory hereto or any person covered by either of the releases provided under section 4 hereof. The Original Participating Manufacturers specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the claims released under section 4 hereof and enter into this STATE Fee Payment Agreement for the sole purposes of memorializing the Original Participating Manufacturers' rights and obligations with respect to payment of attorneys' fees pursuant to the Agreement and avoiding the further expense, inconvenience, burden and uncertainty of potential litigation.

SECTION 27. *Non-admissibility.*

This STATE Fee Payment Agreement having been undertaken by the Parties hereto in good faith and for settlement purposes only, neither this STATE Fee Payment Agreement nor any evidence of negotiations relating hereto shall be offered or received in evidence in any action or proceeding other than an action or proceeding arising under this STATE Fee Payment Agreement.

SECTION 28. *Amendment and Waiver.*

This STATE Fee Payment Agreement may be amended only by a written instrument executed by the Parties. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving Party. The waiver by any Party of any breach hereof shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this STATE Fee Payment Agreement.

SECTION 29. *Notices.*

All notices or other communications to any party hereto shall be in writing (including but not limited to telex, facsimile or similar writing) and shall be given to the notice parties listed on Schedule A hereto at the addresses therein indicated. Any Party hereto may change the name and address of the person designated to receive notice on behalf of such Party by notice given as provided in this section including an updated list conformed to Schedule A hereto.

SECTION 30. *Governing Law.*

This STATE Fee Payment Agreement shall be governed by the laws of the State of STATE without regard to the conflict of law rules of such State.

SECTION 31. *Construction.*

None of the Parties hereto shall be considered to be the drafter hereof or of any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

SECTION 32. *Captions.*

The captions of the sections hereof are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 33. *Execution of STATE Fee Payment Agreement.*

This STATE Fee Payment Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this STATE Fee Payment Agreement.

SECTION 34. *Entire Agreement of Parties.*

This STATE Fee Payment Agreement contains an entire, complete and integrated statement of each and every term and provision agreed to by and among the Parties with respect to payment of attorneys' fees by the Original Participating Manufacturers in connection with the Action and is not subject to any condition or covenant, express or implied, not provided for herein.

IN WITNESS WHEREOF, the Parties hereto, through their fully authorized representatives, have agreed to this STATE Fee Payment Agreement as of this __th day of ________, 1998.

[SIGNATURE BLOCK]

APPENDIX
to MODEL FEE PAYMENT AGREEMENT

PROTOCOL OF PANEL PROCEEDINGS

This Protocol of procedures has been agreed to between the respective parties to the STATE Fee Payment Agreement, and shall govern the arbitration proceedings provided for therein.

SECTION 1. *Definitions.*

All definitions contained in the STATE Fee Payment Agreement are incorporated by reference herein.

SECTION 2. *Chairman.*

The person selected to serve as the permanent, neutral member of the Panel as described in paragraph (b)(ii) of section 11 of the STATE Fee Payment Agreement shall serve as the Chairman of the Panel.

SECTION 3. *Arbitration Pursuant to Agreement.*

The members of the Panel shall determine those matters committed to the decision of the Panel under the STATE Fee Payment Agreement, which shall govern as to all matters discussed therein.

SECTION 4. *ABA Code of Ethics.*

Each of the members of the Panel shall be governed by the *Code of Ethics for Arbitrators in Commercial Disputes* prepared by the American Arbitration Association and the American Bar Association (the "*Code of Ethics*") in conducting the arbitration proceedings pursuant to the STATE Fee Payment Agreement, subject to the terms of the STATE Fee Payment Agreement and this Protocol. Each of the party-appointed members of the Panel shall be governed by Canon VII of the *Code of Ethics.* No person may engage in any *ex parte* communications with the permanent, neutral member of the Panel selected pursuant to paragraph (b)(ii) of section 11, in keeping with Canons I, II and III of the *Code of Ethics.*

SECTION 5. *Additional Rules and Procedures.*

The Panel may adopt such rules and procedures as it deems necessary and appropriate for the discharge of its duties under the STATE Fee Payment Agreement and this Protocol, subject to the terms of the STATE Fee Payment Agreement and this Protocol.

SECTION 6. *Majority Rule.*

In the event that the members of the Panel are not unanimous in their views as to any matter to be determined by them pursuant to the STATE Fee Payment Agreement or this Protocol, the determination shall be decided by a vote of a majority of the three members of the Panel.

SECTION 7. *Application for Fee Award and Other Materials.*

(a) The Application of STATE Outside Counsel and any materials submitted to the Director relating thereto (collectively, "submissions") shall be forwarded by the Director to each of the members of the Panel in the manner and on the dates specified in the STATE Fee Payment Agreement.

(b) All materials submitted to the Director by either Party (or any other person) shall be served upon all Parties. All submissions required to be served on any Party shall be deemed to have been served as of the date on which such materials have been sent by either (i) hand delivery or (ii) facsimile and overnight courier for priority next-day delivery.

(c) To the extent that the Panel believes that information not submitted to the Panel may be relevant for purposes of determining those matters committed to the decision of the Panel under the terms of the STATE Fee Payment Agreement, the Panel shall request such information from the Parties.

SECTION 8. *Hearing.*

Any hearing held pursuant to section 12 of the STATE Fee Payment Agreement shall not take place other than in the presence of all three members of the Panel upon notice and an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Miscellaneous.*

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers on a basis to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all media inquiries regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall refrain from any comment as to the arbitration proceedings to be conducted pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon IV(B) of the *Code of Ethics.*

EXHIBIT P
NOTICES

[Intentionally Omitted]

EXHIBIT Q
1996 AND 1997 DATA

(1) 1996 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	$801,640,000
Lorillard Tobacco Co.	$719,100,000
Philip Morris Inc.	$4,206,600,000
R.J. Reynolds Tobacco Co.	$1,468,000,000
Total (Base Operating Income)	$7,195,340,000

(2) 1997 volume (as measured by shipments of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,911,000,000
Lorillard Tobacco Co.	42,288,000,000
Philip Morris Inc.	236,203,000,000
R.J. Reynolds Tobacco Co.	118,254,000,000
Total (Base Volume)	475,656,000,000

(3) 1997 volume (as measured by excise taxes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,758,000,000
Lorillard Tobacco Co.	42,315,000,000
Philip Morris Inc.	236,326,000,000
R.J. Reynolds Tobacco Co.	119,099,000,000

* The volume includes 2,847,595 pounds of "roll your own" tobacco converted into the number of Cigarettes using 0.0325 ounces per Cigarette conversion factor.

EXHIBIT R
EXCLUSION OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation

GPC
State Express 555
Riviera

Philip Morris Incorporated

Players
B&H
Belmont
Mark Ten
Viscount
Accord
L&M
Lark
Rothman's
Best Buy
Bronson
F&L
Genco
GPA
Gridlock
Money
No Frills
Generals
Premium Buy
Shenandoah
Top Choice

Lorillard Tobacco Company

None

R.J. Reynolds Tobacco Company

Best Choice
Cardinal
Director's Choice
Jacks
Rainbow
Scotch Buy
Slim Price
Smoker Friendly
Valu Time
Worth

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section __. Findings and Purpose.[1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On ______, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on ______, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

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

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

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

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

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

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

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

Section __. Requirements.

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

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

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

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

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

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

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

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

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

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

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

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

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

[2] [All per unit numbers subject to verification]

[3] [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall --

(A) be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

[4] [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed $100,000, will be paid from disbursements from the Subsection VIII(c) Account.

APPENDIX C

THE 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

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

/s/ SGC
J.S.C.

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

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

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

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

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

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

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

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

PRESENT: HON. STEPHEN G. CRANE, *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

TSASC FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND 2004

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TSASC, Inc.

Independent Auditors' Report

Financial Statements
Years Ended June 30, 2005 and 2004

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TSASC, INC.

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Deloitte.

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INDEPENDENT AUDITORS' REPORT

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, New York, as of and for the years ended June 30, 2005 and 2004. These financial statements are the responsibility of the TSASC's management. 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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of TSASC's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2005 and 2004, and the respective changes in financial position thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of TSASC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

September 8, 2005

OVERVIEW OF THE FINANCIAL STATEMENTS

The following is a narrative overview and analysis of the financial performance of the financial activities of TSASC, Inc. ("TSASC") for the fiscal year ended June 30, 2005. It should be read in conjunction with TSASC's entity-wide financial statements, governmental funds financial statements and the notes to the financial statements.

The annual financial statements consist of three parts: (1) management's discussion and analysis (this section); (2) the entity-wide financial statements; and (3) the governmental funds financial statements.

The entity-wide financial statements of TSASC, which include the statements of net assets (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") Statement No. 34 - Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as amended by GASB Statement No. 37 and by Statement No. 38. The statements of net assets (deficit) and the statements of activities are prepared using the economic resources measurement focus and the accrual basis of accounting. All revenues and expenses are taken into account regardless of when cash is paid or received. This is to provide the reader with a broad overview of TSASC's finances, which is similar to private-sector financial statements.

TSASC's governmental funds financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it becomes susceptible to accrual, which 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 unmatured interest on bonds payable, which is recognized when due.

The reconciliations of the statement of revenues, expenditures and changes in fund balances of governmental funds to the statement of activities are presented to assist the reader in understanding the differences between entity-wide and governmental funds financial statements.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - ENTITY-WIDE FINANCIAL STATEMENTS

On June 16, 2003, an Original Participating Manufacturer ("OPM") under the Master Settlement Agreement ("MSA") with a market share of 7% or more was downgraded below Baa3 by Moody's Investors Service. This constituted a "Downgrade Trapping Event" as defined in the Indenture (the "Indenture"), dated as of November 1, 1999, between TSASC and the Bank of New York as Trustee, which requires the funding of an additional reserve for the benefit of TSASC bondholders from amounts that would otherwise be paid to New York City (the "City"). The Indenture requires that each installment of tobacco settlement revenues ("TSRs") and other revenue received after the occurrence of a Downgrade Trapping Event be deposited in the trapping account established under the Indenture in an amount equal to the lesser of (a) 25% of the principal amount of outstanding bonds or (b) that portion of revenue equal to the ratio of the principal amount of bonds issued to $2.76 billion. At June 30, 2005 and 2004 that ratio was 49.61% and 47.86%, respectively, of TSRs and other revenues. Deposits in the trapping account continue until an amount equal to the trapping requirement is retained. The trapping requirement is 25% of the outstanding principal amount of TSASC bonds, or approximately $320.8 million and $313.9 million as of June 30, 2005 and 2004, respectively. The amounts on deposit in the trapping account, including accrued interest, as of June 30, 2005 and 2004 were $128.6 million and $60.4 million, respectively. Based on the projection of TSRs made in August 2002 in connection with the issuance of TSASC's Series 2002-1 Bonds, it is anticipated that the trapping requirement will be fulfilled in April 2008, or earlier if funded from sources other than TSRs.

On September 15, 2003, TSASC announced that it does not intend to issue any additional bonds to the public under the Indenture and that it is reviewing restructuring alternatives for its outstanding bonds. TSASC and the City are considering various alternatives to eliminate or fulfill the trapping requirement, some of which would not involve a refunding of TSASC's bonds. No decision has been reached as to the method or as to the timing of any restructuring.

Total assets increased by $64 million (17%) which is due primarily to the increase in the amount held in the trapping account, offset slightly by a reduction in TSRs receivable and unamortized bond issuance costs. The components of the increase in total assets are (1) an increase in restricted cash and cash equivalents of $170.2 million (149%), (2) a decrease in restricted investments of $102.7 million (70.7%), (3) a decrease in unamortized bond issue costs of $1 million (6%), and (4) a $2 million decrease (2%) in tobacco settlement revenue receivable at June 30, 2005.

Total liabilities increased by $27 million (2%), primarily due to (1) an increase in bonds payable of $28.8 million (2%) which includes bonds issued of $47.4 million, a decrease of unamortized bond discount of $1.3 million and a decrease due to $20.8 million of bonds retired, (2) a decrease of remittances payable to the TSASC Tobacco Settlement Trust (the "Trust") of $2.5 million (5.6%), and (3) a decrease of $0.73 million (2.2%) in accrued interest and expenses payable at June 30, 2005.

Gross TSRs increased by $3.1 million (1.5%). This increase is consistent with the projection of TSRs that was made in August 2002 in connection with the issuance of TSASC's Series 2002-1 Bonds. Net TSRs decreased by $.4 million in the fiscal year ended June 30, 2005. This decrease is attributed to a increase of remittances to the Trust of $3.5 million (5.7%) in addition to the increase of $3.1 million (1.5%) of TSRs received. TSASC will also hold in the trapping account $41.7 million of the $84 million of TSRs accrued and receivable at June 30, 2005, when the funds are received in April 2005.

Total program expenses increased by $9.5 million (8.5%). This increase in program expenses resulted from an increase of $7.8 million (21.6%) in distributions to the Trust for the New York City capital program and an increase of $1.6 million (2.1%) in bond interest expense, which is due to the additional bonds issued during the years ended June 30, 2005 and 2004.

FINANCIAL HIGHLIGHTS AND OVERALL ANALYSIS - GOVERNMENTAL FINANCIAL STATEMENTS

Total assets increased by $65 million (18.5%), which is due primarily to the increase in the amount held in the trapping account, an increase in liquidity reserves and a decrease in required retention for debt service. The components of this increase are (1) an increase in restricted cash and cash equivalents of $170.2 million (149%), (2) a decrease in restricted investments of $102.7 million (70.7%), and (3) a $2 million decrease (2.3%) in TSRs receivable at June 30, 2005 and the corresponding decrease in deferred revenue of $2 million (2.3%).

Gross TSRs increased by $3.2 million (1.5%). TSRs retained increased by $2.5 million. The increase is due primarily to the increase in the amount held in the trapping account.

Total expenditures decreased by $13 million. The primary reason for the decreases consist of a decrease of $21.6 million (51%) in the principal amount of bonds retired, partially offset by an increase of $7.8 million (21.6%) in distributions to the Trust for the New York City capital program.

* * * * * *

TSASC, INC.

STATEMENTS OF NET ASSETS (DEFICIT)
JUNE 30, 2005 AND 2004
(In Thousands)

	2005	2004
ASSETS		
Restricted cash and cash equivalents	$ 284,464	$ 114,257
Unrestricted cash and cash equivalents	6,054	740
Restricted investments	42,670	145,365
Unrestricted investments	-	5,762
Tobacco settlement revenue receivable	84,000	86,000
Unamortized bond issuance cost	14,676	15,655
Total assets	431,864	367,779
LIABILITIES		
Accrued expenses	14	66
Accrued interest payable	34,366	33,589
Remittances payable to the Trust	42,325	44,837
Bonds payable:		
Portion due within one year	14,654	20,755
Portion due after one year	1,268,643	1,234,964
Unamortized bond discount	(17,197)	(18,456)
Total liabilities	1,342,805	1,315,755
NET ASSETS (DEFICIT)		
Restricted for debt service	327,135	259,623
Deficit	(1,238,076)	(1,207,599)
TOTAL DEFICIT	$ (910,941)	$ (947,976)

See notes to financial statements.

TSASC, INC.

STATEMENTS OF ACTIVITIES
YEARS ENDED JUNE 30, 2005 AND 2004
(In Thousands)

	2005	2004
EXPENSES		
General and administrative expenses	$ 670	$ 583
Distributions to New York City for capital program	44,140	36,312
Interest expense	75,565	73,987
Amortization of bond issuance expense	979	996
Total program expenses	121,354	111,878
GENERAL REVENUES		
Tobacco settlement revenue	214,920	211,826
Less remittances to the Trust	(65,067)	(61,541)
Net tobacco settlement revenue	149,853	150,285
Investment earnings	8,536	6,260
Total general revenues	158,389	156,545
CHANGES IN DEFICIT	37,035	44,667
DEFICIT, beginning of year	(947,976)	(992,643)
DEFICIT, end of year	$ (910,941)	$ (947,976)

See notes to financial statements.

TSASC, INC.

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2005
(In Thousands)

	Capital Projects	Debt Service	Total Governmental Funds
ASSETS			
Restricted cash and cash equivalents	$ -	$ 284,464	$ 284,464
Unrestricted cash and cash equivalents	-	6,054	6,054
Restricted investments	-	42,670	42,670
Tobacco settlement revenue receivable	-	84,000	84,000
Total assets	$ -	$ 417,188	$ 417,188
LIABILITIES AND FUND BALANCES			
Liabilities			
Accrued expenses	$ -	$ 14	$ 14
Deferred tobacco settlement revenue	-	84,000	84,000
Total liabilities	-	84,014	84,014
Fund balances			
Restricted for debt service	-	327,134	327,134
Unrestricted	-	6,040	6,040
Total fund balances	-	333,174	333,174
Total liabilities and fund balances	$ -	$ 417,188	$ 417,188

See notes to financial statements.

TSASC, INC.

BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004
(In Thousands)

	Capital Projects	Debt Service	Total Governmental Funds
ASSETS			
Restricted cash and cash equivalents	$ 740	$ 114,257	$ 114,997
Restricted investments	5,762	145,365	151,127
Tobacco settlement revenue receivable	-	86,000	86,000
Total assets	$ 6,502	$ 345,622	$ 352,124
LIABILITIES AND FUND BALANCES			
Liabilities			
Accrued expenses	$ 66	$ -	$ 66
Deferred tobacco settlement revenue	-	86,000	86,000
Total liabilities	66	86,000	86,066
Fund balances			
Restricted for capital program	6,436	-	6,436
Restricted for debt service	-	259,622	259,622
Total fund balances	6,436	259,622	266,058
Total liabilities and fund balances	$ 6,502	$ 345,622	$ 352,124

See notes to financial statements.

TSASC, INC.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2005
(In Thousands)

	Capital Projects	Debt Service	Total Governmental Funds
REVENUES			
Tobacco settlement revenue	$ -	$ 216,920	$ 216,920
Less remittances to the Trust	-	(67,579)	(67,579)
Tobacco settlement revenue retained	-	149,341	149,341
Investment earnings	133	8,403	8,536
Total revenues	133	157,744	157,877
EXPENDITURES			
Interest expense	-	72,601	72,601
Principal amount of bonds retired	-	20,755	20,755
Distributions to the Trust for capital expenditures	44,140	-	44,140
General and administrative expenses	670	-	670
Total expenditures	44,810	93,356	138,166
Excess of (expenditures) over revenues; revenues over expenditures	(44,677)	64,388	19,711
OTHER FINANCING SOURCES (USES)			
Principal amount of bonds issued	47,405	-	47,405
Transfers in (out)	(9,164)	9,164	-
Total other financing sources	38,241	9,164	47,405
NET CHANGES IN FUND BALANCES	(6,436)	73,552	67,116
FUND BALANCES, beginning of year	6,436	259,622	266,058
FUND BALANCES, end of year	$	$ 333,174	$ 333,174

See notes to financial statements.

TSASC, INC.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
YEAR ENDED JUNE 30, 2004
(In Thousands)

	Capital Projects	Debt Service	Total Governmental Funds
REVENUES			
Tobacco settlement revenue	$ -	$ 213,726	$ 213,726
Less remittances to the Trust	-	(66,934)	(66,934)
Tobacco settlement revenue retained	-	146,792	146,792
Investment earnings	22	6,238	6,260
Total revenues	22	153,030	153,052
EXPENDITURES			
Interest expense	-	72,059	72,059
Principal amount of bonds retired	-	42,310	42,310
Distributions to the Trust for capital expenditures	36,312	-	36,312
General and administrative expenses	583	-	583
Total expenditures	36,895	114,369	151,264
Excess of (expenditures) over revenues; revenues over expenditures	(36,873)	38,661	1,788
OTHER FINANCING SOURCES (USES)			
Principal amount of bonds issued	38,997	-	38,997
Transfers in (out)	3,062	(3,062)	-
Total other financing sources	42,059	(3,062)	38,997
NET CHANGES IN FUND BALANCES	5,186	35,599	40,785
FUND BALANCES, beginning of year	1,250	224,023	225,273
FUND BALANCES, end of year	$ 6,436	$ 259,622	$ 266,058

See notes to financial statements.

TSASC, INC.

RECONCILIATIONS OF THE GOVERNMENTAL FUNDS BALANCE SHEETS TO THE STATEMENTS OF NET ASSETS YEARS ENDED JUNE 30, 2005 AND 2004
(In Thousands)

	2005	2004
Total fund balance - governmental funds	$ 333,174	$ 266,058
Amounts reported for governmental activities in the statement of net assets are different because:		
Costs of debt issuance are expenditures in governmental activities. However, in the statement of net assets, the costs of debt issuance are reported as capitalized assets and amortized over the life of the related debt.	14,676	15,655
Bond discounts are reported as other financing uses in the governmental funds financial statements. However, in the statement of net assets, bond discounts are reported as a component of bonds payable and amortized over the lives of the related debt.	17,197	18,456
Deferred tobacco settlement revenue in the governmental fund financial statements is recognized as revenue and not deferred in the statement of net assets.	84,000	86,000
Liability due to the Trust for its share of the tobacco settlement revenue is deferred in the governmental funds, however it is recognized in the current period in the statement of net assets.	(42,325)	(44,837)
Some liabilities are not due and payable in the current period from currently available financial resources and therefore are not reported in the governmental funds financial statements. Those liabilities consist of:		
Bonds payable	(1,283,297)	(1,255,719)
Accrued interest on bonds	(34,366)	(33,589)
Net deficit of governmental activities	$ (910,941)	$ (947,976)

See notes to financial statements.

TSAC, INC.

RECONCILIATIONS OF THE STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENTS OF ACTIVITIES
YEARS ENDED JUNE 30, 2005 AND 2004
(In Thousands)

	2005	2004
Net change in fund balances - total governmental funds	$ 67,116	$ 40,785
Amounts reported for governmental activities in the statement of activities are different because:		
Bond proceeds provide current financial resources to governmental funds, but debt issued increases long-term liabilities in the statement of net assets.	(47,405)	(38,997)
Tobacco settlement revenue is deferred in governmental funds and included in revenue in the statement of activities.	(2,000)	(1,900)
Tobacco settlement revenue is deferred in governmental funds and included in remittances to the Trust in the statement of activities.	2,512	5,393
Interest expense in the statement of activities recorded as additional debt on the TIFIA loan is not reported as expenditure in governmental funds.	(928)	(712)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	20,755	42,310
Governmental funds report the cost of debt issuance as expenditures. However, in the statement of activities, the cost of debt issuance is amortized over the life of the related debt.	(979)	(996)
Governmental funds report bond discounts as other financing uses. However, in the statement of activities, bond discounts are amortized over the lives of the related debt as interest expense.	(1,259)	(1,290)
Interest expense is reported in the statement of activities on the accrual basis, but interest is reported as an expenditure in the governmental funds when the outlay of financing resources is required.	(777)	74
Change in net deficit of governmental activities	$ 37,035	$ 44,667

See notes to financial statements.

1. ORGANIZATION

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 (who also serves as Chairperson), 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, accordingly, is included in the City's financial statements.

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 provides 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 rights, 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 has been financed by the issuance of a series of bonds and the Residual Certificate. The Residual Certificate represents the entitlement to receive all amounts required to be distributed after payment of debt service, operating expenses and certain other costs as set forth in the Indenture. Payments on the Residual Certificate from TSR collections are subordinate to payments on the bonds and payment of certain other costs specified in the Indenture. Excess TSRs not required by TSASC to pay various expenses, debt service or required reserves with respect to the bonds are transferred to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate. The City is the beneficial owner of the Trust and thus the funds received by the Trust are transferred to the City.

TSASC does not have any employees; its affairs are administered by employees of another component unit of the City, for which TSASC pays a management fee based on its allocated share of personnel and overhead costs.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The entity-wide financial statements of TSASC, which include the statement of net assets (deficit) and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with Statement No. 34 of the Governmental Accounting Standards Board. The statement of net assets (deficit) and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

TSASC's governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it becomes susceptible to accrual, which 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 unmatured interest on bonds payable, which is recognized when due. The governmental funds financial statements consist of the Capital Projects Fund, which accounts for resources to be transferred to the City's capital program and supports the operations of TSASC, and the Debt Service Fund, which accounts for the accumulation of resources for payment of principal and interest on debt. At June 30, 2005 all of the assets, liabilities and the fund balance of the Capital Projects Fund were transferred to the Debt Service Fund since TSASC does not anticipate issuing debt for capital projects.

Investments, including accrued interest, are reported at fair value.

In accordance with GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues,* TSASC records a receivable for TSRs at June 30th. The TSRs are expected to be received the following April and are based on an estimate of cigarette sales for the six month period January 1 to June 30.

Bond premiums, discounts and issuance costs are capitalized and amortized over the life of the related debt using the interest method in the entity-wide financial statements. The amount of unamortized bond discount at June 30, 2005 and 2004 was $17,197,000, and $18,456,000, which is net of accumulated amortization of $5,098,000 and $3,840,000 respectively. The governmental funds financial statements recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Interest expense is recognized on the accrual basis in the entity-wide financial statements. Interest expenditures are recognized when paid in the individual governmental funds financial statements.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSASC's management to make estimates and assumptions in determining the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

3. BONDS PAYABLE

In connection with the purchase of the City's future right, title and interest in the TSRs, TSASC anticipated issuing obligations in an aggregate principal amount of $2.76 billion, of which TSASC has issued $1.370 billion and $1.322 billion as of June 30, 2005 and 2004 respectively. TSASC has pledged all of its tangible and intangible assets, including the TSRs, all investment earnings, and amounts on deposit in all reserve accounts established under the Indenture, as collateral to secure its bonds. TSASC retains TSRs in an amount sufficient to service its debt not otherwise provided from bond proceeds, to fund the trapping account (as described below) and to pay its operating expenses, and remits the remaining balance to the Trust.

3. BONDS PAYABLE (CONTINUED)

On June 16, 2003, an Original Participating Manufacturer ("OPM") in the MSA with a market share of 7% or more was downgraded below Baa3 by Moody's Investors Services. This constituted a "Downgrade Trapping Event" as defined in the Indenture (the "Indenture"), dated as of November 1, 1999, between TSASC and the Bank of New York as Trustee, which requires the funding of an additional reserve for the benefit of TSASC bondholders from amounts that would otherwise be paid to the City. The Indenture requires that tobacco settlement revenues ("TSRs") and other revenue received after the occurrence of a Downgrade Trapping Event in an amount equal to the lesser of (a) 25% of the principal amount of outstanding bonds or (b) that portion of each payment equal to the ratio of the principal amount of bonds issued to $2.76 billion be deposited in the trapping account established under the Indenture. Accordingly, as of June 30, 2005, 49.61% of the TSRs and other revenues will be deposited in the trapping account until an amount equal to the trapping requirement is retained. The trapping requirement is 25% of outstanding principal of TSASC bonds, or $320.8 million and $313.9 million as of June 30, 2005 and 2004, respectively. Based on the projection of TSRs made in August 2002 in connection with the issuance of TSASC's Series 2002-1 Bonds, it is anticipated that the trapping requirement will be met in April 2008, or earlier if funded from sources other than TSRs.

Until the trapping requirement is met, TSASC is not permitted under the Indenture to issue additional bonds (other than for refunding purposes) without confirmation from each rating agency that such issuance will not result in a reduction or withdrawal of the ratings on TSASC's bonds (a "rating confirmation"). Rating confirmations have been received for periodic loan draws under the TIFIA Agreement.

On September 15, 2003, TSASC announced that it does not intend to issue any further additional bonds to the public under the Indenture and that it is reviewing restructuring alternatives for its outstanding bonds. TSASC and the City are considering various alternatives to eliminate the trapping requirement, some of which would not involve a refunding of its bonds. No decision has been reached as to the method or as to the timing of any restructuring.

On December 1, 2001, TSASC, the City and the United States Department of Transportation ("USDOT") entered into a Secured Loan Agreement and Inducement Agreement (the "TIFIA Agreement"). The Agreement provides that USDOT will purchase up to $159,161,429 of TSASC bonds, the proceeds of which are to be used by the City to pay a portion of its Staten Island Ferries and Ferry Terminal Project. As of June 30, 2005, TSASC has borrowed the maximum allowed under the TIFIA Agreement.

In addition, the TIFIA Agreement provides that interest on borrowings after April 10th of each year, which would be paid the next July 15th and January 15th, will be added to the principal of bonds payable (capitalized). As of June 30, 2005 capitalized interest increased the total amount borrowed by $1,885,660 for a total of due of $161,047,088.

3. BONDS PAYABLE (CONTINUED)

Outstanding bonds payable bear interest at rates ranging from 3.0% to 6.375%. A summary of changes in outstanding bonds during the fiscal year ended June 30, 2005 is as follows (in thousands):

	Balance June 30, 2004	Fiscal Year Ended June 30, 2005 Bonds Issued		Bonds Retired	Balance June 30, 2005
Series 1999-1	$ 676,800	$ -		$ (6,520)	$ 670,280
Bonds issued under TIFIA Agreement	112,714	48,333	(a)	-	161,047
Series 2002-1	466,205	-		(14,235)	451,970
Totals	$ 1,255,719	$ 48,333		$ (20,755)	$ 1,283,297

Outstanding bonds payable bear interest at rates ranging from 3.0% to 6.375%. A summary of changes in outstanding bonds during the fiscal year ended June 30, 2004 is as follows (in thousands):

	Balance June 30, 2003	Fiscal Year Ended June 30, 2004 Bonds Issued		Bonds Retired	Balance June 30, 2004
Series 1999-1	$ 685,315	-		$ (8,515)	$ 676,800
Bonds issued under TIFIA Agreement	73,005	39,709	(a)	-	112,714
Series 2002-1	500,000	-		(33,795)	466,205
Totals	$ 1,258,320	$ 39,709		$ (42,310)	$ 1,255,719

(a) During the years ended June 30, 2005 and 2004, bonds issued under the TIFIA Agreement include capitalized interest of $928 and $712 respectively.

3. BONDS PAYABLE (CONTINUED)

Debt service requirements for planned principal payments and rated maturities, including principal and interest at June 30, 2005, are as follows (in thousands):

	Planned Principal Payments			Rated Maturities		
	Principal	Interest	Total	Principal	Interest	Total
Year ended June 30,						
2006	$ 14,654	$ 74,530	$ 89,184	$ -	$ 75,357	$ 75,357
2007	17,046	73,939	90,985	1,425	75,336	76,761
2008	17,214	73,208	90,422	1,420	75,278	76,698
2009	25,960	72,128	98,088	7,735	75,133	82,868
2010	28,124	70,743	98,867	8,390	74,808	83,198
2011 to 2015	170,175	328,070	498,245	86,802	363,230	450,032
2016 to 2020	273,163	267,386	540,549	100,420	341,166	441,586
2021 to 2025	413,166	162,988	576,154	237,407	289,361	526,768
2026 to 2030	284,278	52,934	337,212	297,817	210,355	508,172
2031 to 2035	39,517	4,500	44,017	297,437	116,184	413,621
2036 to 2040	-	-	-	244,444	37,802	282,246
	$ 1,283,297	$ 1,180,426	$ 2,463,723	$ 1,283,297	$ 1,734,010	$ 3,017,307

The planned principal payments represent the amount of principal that TSASC has covenanted to pay to the extent of available TSRs collected. Rated 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.

At June 30, 2005 and 2004, TSASC has funded its debt service accounts in accordance with the planned debt service schedule. At June 30, 2005 and 2004 debt service accounts totaled $89,184,000 and $93,356,000, respectively, which includes $14,654,000 and $20,755,000, respectively, for principal retirement; $74,530,000 and $72,601,000, respectively, for interest payments.

At June 30, 2005 and 2004, TSASC has funded its liquidity reserves of $106,350,000 and $103,085,000, respectively. At June 30, 2005 and 2004, $95,388,000 of liquidity reserves was invested in two forward delivery contracts, collateralized by securities held by the TSASC trustee in TSASC's name. The guaranteed rates of return are 6.386% and 5.10%, respectively. At June 30, 2005 and 2004 TSASC had on deposit $3,062,000 and $2,880,000, respectively, of interest earnings; and $128,538,000 and $60,425,000, respectively, including accrued interest, held in the trapping account.

Transfers from Capital Projects to Debt Service in the "Statements of Revenues, Expenditures, and Changes in Fund Balances Governmental Funds" are primarily due to the transfer of capital funds from bond proceeds in connection with the issuance of bonds for the TIFIA loan to the debt service liquidity reserve fund.

4. CASH AND CASH EQUIVALENTS

TSASC's cash and cash equivalents consist of bank deposits, forward delivery contracts, commercial paper and short-term U.S. Government-guaranteed securities with original maturities of three months or less and are held by TSASC's trustee in TSASC's name valued at fair value. The commercial paper was rated A1+ by Standard & Poor's Rating Services and P1 by Moody's Investor Services. At June 30, 2005 and 2004, total cash and cash equivalents are summarized as follows:

	June 30, 2005	June 30, 2004
Restricted cash and cash equivalents		
Cash	$ 5	$ 91
Commercial paper	229,261	59,676
Forward delivery contract collateralized by U.S. Government Securities (a)	55,198	55,230
	$ 284,464	$ 114,997
Unrestricted Cash and cash equivalents		
Cash	$ 67	$ -
Commercial paper	5,987	-
	$ 6,054	$ -

(a) Valued at fair value of collateral

5. INVESTMENTS

TSASC is generally authorized to invest in direct obligations of or obligations guaranteed by the U.S. government and highly rated U.S. municipal obligations. TSASC is also authorized to invest in certain highly rated commercial paper, highly rated short-term corporate securities, highly rated taxable money market funds, and investment agreements or guaranteed investment contracts with highly rated financial institutions or corporations.

5. INVESTMENTS (CONTINUED)

At June 30, 2005 and 2004 investments were held by TSASC's trustee in TSASC's name. The commercial paper was rated A1+ by Standard & Poor's Rating Services and P1 by Moody's Investor Services and the investments are summarized as follows:

	June 30,	
	2005	**2004**
Restricted investments		
Commercial paper	$ -	$ 102,328
U.S. Government securities	-	6,105
Forward delivery contract collateralized by U.S. Government Securities (a)	18	-
Forward delivery contract collateralized by commercial paper (a)	42,652	42,694
	$ 42,670	$ 151,127

(a) Valued at fair value of collateral

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APPENDIX E

PROPOSED FORM OF
OPINION OF COUNSEL

February __, 2006

TSASC, Inc.
75 Park Place
New York, New York 10007

Re: $__________ TSASC, Inc.
Tobacco Settlement Asset-Backed Bonds, Series 2006-1

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 Asset-Backed Bonds, Series 2006-1 (the "Bonds"), pursuant to an Amended and Restated Indenture, dated as of January 1, 2006 (the "Indenture"), by and between the Corporation and The Bank of New York, as successor 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.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Agreement, the Tax Certificates and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. 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, 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, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents. 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 Collateral as it 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 and constitutes a valid and binding agreement of the Corporation.

4. 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.

5. 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 excluded from New York adjusted gross income for purposes of personal income taxes imposed by the State of New York and any political subdivision thereof (including The City of New York), to the extent that such interest is excluded from gross income for federal income tax purposes. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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APPENDIX F

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 Bear, Stearns & Co. Inc., as representative of the underwriters, relating to the sale of the Series 2006-1 Bonds, in such form as the parties thereto will agree.

"**Business Day**" means any day other than a Saturday, a Sunday, or a day on which banking institutions in New York, New York are required or authorized by law to be closed..

"**Capitalized Interest Subaccount**" means the subaccount of the Debt Service Account held by the Trustee pursuant to the Indenture.

"**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.

“**Cumulative Actual Turbo Redemptions**” means, as of June 1, 2024, and each June 1 thereafter, the principal amount of all actual redemptions from the date of issuance of the Series 2006-1 Bonds through and including such June 1.

“**Cumulative Projected Turbo Redemptions**” means, as of June 1, 2024, and each June 1 thereafter, the amount shown on Exhibit C under “Cumulative Projected Turbo Redemptions” opposite such June 1.

“**Debt Service Account**” means the Account of such name held by the Trustee pursuant to the Indenture.

“**Defeasance Collateral**” means money and:

(a) direct obligations of the United States government, which are not redeemable at the option of the issuer thereof;

(b) (i) obligations, the timely payment of the principal and interest on which are unconditionally guaranteed by the United States government; (ii) certificates of deposit of banks or trust companies secured by obligations of the United States of America of a market value equal at all times to the amount of the deposit; (iii) notes, bonds, debentures, mortgages and other evidences of indebtedness, issued or guaranteed at the time of the investment by the United States Postal Service, Fannie Mae, FHLMC, the Student Loan Marketing Association, the Federal Farm Credit System, or any other United States government sponsored agency; (iv) notes, bonds, debentures, mortgages and other evidences of indebtedness, issued or guaranteed at the time of investment by the Asian Development Bank, Bank Noderlandse Gementen, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank and International Bank for Reconstruction and Development; or (v) bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state (x) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, and (y) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii), (iii) or (iv) which fund may be applied only to the payment when due of such bonds or other obligations; provided that the above-listed investments are not redeemable at the option of the issuer thereof and which will be rated at the time of the investment in the highest long-term rating category by each Rating Agency;

(c) any depositary receipt issued by an Eligible Bank as custodian with respect to any Defeasance Collateral which is specified in clause (a) above and held by such Eligible Bank for the account of the holder of such depositary receipt, or with respect to any specific payment of principal of or interest on any such Defeasance Collateral which is so specified and held, provided that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depositary receipt from any amount received by the custodian in respect of the Defeasance Collateral or the specific payment of principal or interest evidenced by such depositary receipt;

(d) any certificate of deposit specified in the definition of "Eligible Investments" below, including certificates of deposit issued by the Trustee or by a Paying Agent or by an affiliate of the Trustee or a Paying Agent, secured by obligations specified in clause (a) 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 in the highest long-term rating category by each Rating Agency; or

(e) investment arrangements that are rated or with providers whose senior unsecured debt obligations are rated in the highest long term and short term rating category by each Rating Agency.

"**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.

"**Defeased Turbo Term Bonds**" means Turbo Term Bonds for which a defeasance escrow has been established pursuant to 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 (iv) federal branch or agency pursuant to the International Banking Act of 1978 or any successor provisions of law, or domestic branch or agency of a foreign bank which branch or agency is duly licensed or authorized to do business under the laws of any state or territory of the United States of America.

"**Eligible Investments**" means, with respect to the Accounts:

(a) Defeasance Collateral;

(b) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, Fannie Mae, FHLB, the Federal Farm Credit System or the Tennessee Valley Authority;

(c) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank (including the Trustee and any of its affiliates) or trust company, savings and loan association, or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch;

(d) certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a state or a political subdivision thereof rated by each Rating Agency maintaining a rating thereon in one of its three highest ratings categories;

(e) commercial or finance company paper (including both noninterest-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 at least "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch, if rated by Fitch;

(f) repurchase obligations with respect to any security described in paragraphs (b)(i), (ii) or (iii) of the definition of Defeasance Collateral above entered into with a primary dealer, depository institution, or trust company (acting as principal) rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated by each Rating Agency maintaining a rating thereon in one of its three highest long term rating categories, or collateralized by securities described in paragraphs (b)(i), (ii) or (iii) of the definition of Defeasance Collateral above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee will have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of 30 days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is at least the greater of 102% or the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended;

(g) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch, at the time such investment or contractual commitment providing for such investment; provided that securities issued by any such corporation will not be Eligible Investments to the extent that investment therein would cause the then-outstanding principal amount of securities issued by such corporation that are then held to exceed 20% of the aggregate principal amount of all Eligible Investments then held;

(h) units of taxable or tax-exempt money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated by each Rating Agency in one of its three highest rating categories, including if so rated any such fund which the Trustee or an affiliate of the Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (x) the Trustee or an affiliate of the Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (y) the Trustee charges and collects fees and expenses for services rendered pursuant to the 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);

(i) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, by each Rating Agency maintaining a rating thereon in one of its three highest rating categories, if the Corporation has an option to terminate such agreement in the event that such rating is downgraded below the rating on the Bonds, or if not so rated, then collateralized by securities described in paragraphs (b)(i), (ii) or (iii) of the definition of Defeasance Collateral above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated in one of the three highest rating categories by each Rating Agency; provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee will have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of 30 days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is at least the greater of 102% or the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended;

(j) a surety, guaranty, liquidity agreement, agreement to purchase securities of the Corporation or other similar agreement provided by an entity with a rating in the three highest rating categories by each Rating Agency; provided that any cost related to such an investment be paid either from funds released from the Liquidity Reserve Account or Unpledged TSRs; and

(k) other obligations or securities that are non-callable and that are acceptable to each Rating Agency;

provided, that no Eligible Investment may (i) evidence the right to receive only interest with respect to prepayable obligations underlying such instrument, or (ii) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity. Any references to a Rating Agency in this definition will apply only if and to the extent that the obligations described are then rated by such Rating Agency.

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 or, if so specified, of the Trustee.

"**Operating Contingency Account**" means the Account held by the Trustee pursuant to the Indenture.

"**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, or delivered to the Trustee for credit against a principal payment; (ii) Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds 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 the Applicable Percentage of the Tobacco Assets as of such date. “Applicable Percentage” means 38.48%; provided, however, that on June 1, 2024 and on each June 1 thereafter if Cumulative Actual Turbo Redemptions equal or exceed the Cumulative Projected Turbo Redemptions, the “Applicable Percentage” will mean the percentage shown on Exhibit C thereto opposite such June 1 and will become effective on the next day.

Upon the issuance of Additional Bonds or Refunding Bonds this definition of Pledged Tobacco Settlement Revenues will be amended to take into account the issuance of such Bonds.

“**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 each nationally recognized securities rating service that has, at the request of the Corporation, a rating then in effect for the Bonds.

“**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 a 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.

“**Sinking Fund Installment**” means each respective principal payment to be made on Turbo Term Bonds scheduled to be made from Collections pursuant to the Indenture, as such schedule is set forth in a Series Supplement.

“**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.

“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.

"**Transaction Documents**" means the TSR Purchase Agreement, the Indenture and the Trust Agreement.

"**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 Account**" means the 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 SERIES 2006-1 Bonds**" and "**THE SERIES 2006-1 Bonds**" herein, for further descriptions of certain terms and provisions of the Bonds.*

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 Swap Payments, the Corporation pledges to the Trustee, and grants to the Trustee a first priority 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) any payment received by the Corporation pursuant to a Swap Contract or pursuant to an investment agreement or forward purchase agreement relating to any Pledged Account; and (v) 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. 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, the Residual Certificate and Swap Payments, 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 and any party that has entered into a Swap Contract.

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 thereunder 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 under 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 obligation 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.

(C) *Defeasance of Turbo Term Bonds*. For each Defeased Turbo Term Bond of the same Maturity Date and series, the Corporation must determine a "Pro Rata Defeasance Redemption Schedule" as described in paragraphs (1) and (2) below. In establishing the defeasance escrow, the Defeased Turbo Term Bonds may not be redeemed more slowly than the Pro Rata Defeasance Redemption Schedule.

(1) For a given Turbo Term Bond Maturity, the Trustee will determine the pro rata portion of each Projected Turbo Redemption (shown in the table of Projected Turbo Redemptions herein; see "THE SERIES 2006-1 BONDS – Turbo Redemptions") that is allocable to the Defeased Turbo Term Bonds. The pro rata portion of each Projected Turbo Redemption will be calculated as of the date of the defeasance by: (a) deducting the Turbo Redemptions which have already occurred from the earliest Projected Turbo Redemptions to arrive at a schedule of "Projected Turbo Redemptions Adjusted for Prior Payments"; (b) calculating a ratio of the par amount to be defeased of each Turbo Term Bond Maturity divided by the then Outstanding par amount of the Turbo Term Bond Maturity; and (c) applying that ratio to the Projected Turbo Redemptions Adjusted for Prior Payments, resulting in a schedule for each Turbo Term Bond Maturity defined as the "Pro Rata Defeasance Redemption Schedule."

(2) The Trustee will establish a defeasance escrow which, for each Defeased Turbo Term Bond Maturity: (a) redeems on the earliest possible date the Pro Rata Defeasance Redemptions which were originally projected to occur prior to the date of the defeasance, if any; and (b) thereafter, redeems the Pro Rata Defeasance Redemptions according to their schedule.

(3) In order to establish the Projected Turbo Redemption Schedule in effect for each Turbo Term Bond Maturity after each partial defeasance, the Trustee will determine the schedule of Projected Turbo Redemptions Adjusted for Prior Payments then applicable and permanently subtract the Pro Rata Defeasance Redemption Schedule from such schedule of Projected Turbo Redemptions Adjusted for Prior Payments.

(4) The provisions above will not be construed to limit the optional redemption of Bonds of a series pursuant to the applicable Series Supplement.

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:

(1) the Collections Account;

(2) the Debt Service Account, and within the Debt Service Account a Capitalized Interest Subaccount;

(3) the Partial Lump Sum Payment Amount

(4) the Operating Account;

(5) the Liquidity Reserve Account;

(6) the Operating Contingency Account;

(7) the Turbo Redemption Account;

(8) the Rebate Account; and

(9) the Costs of Issuance Account.

Investments

Generally. Pending its use under the Indenture, money in the Accounts held by the Trustee may be invested by the Trustee in Eligible Investments maturing or redeemable at the option of the holder at or before the time when such money is expected to be needed and will be so invested as directed in an Officer's Certificate. Eligible Investments will mature or be redeemable at the option of the Corporation on or before each next succeeding Distribution Date, except in the case of the Capitalized Interest Subaccount or 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, Turbo Term Bond Maturities and Sinking Find Installments pursuant to the terms of the Indenture on such next succeeding Distribution Dates. 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 Account. No later than May 15 of each year commencing May 15, 2006, the Trustee will value the money and investments in the Liquidity Reserve Account according to the methods set forth in the Indenture. Any amounts in the Liquidity Reserve Account in excess of the 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 the 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 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. In the event no Event of Default has occurred and an investment meeting the requirements of (j) of the definition of Eligible Investments is deposited into the Liquidity Reserve Account such that the cash and the value of such Eligible Investment exceed the Liquidity Reserve Requirement, such excess cash will be transferred to the Unpledged TSRs Account.

Valuation. In computing the amount in any Account, the value of Eligible Investments will be calculated as follows:

(1) as to investments the bid and asked prices of which are published on a regular basis in a recognized pricing service subscribed to by the Trustee, or The Wall Street Journal (or, if not there, then in The New York Times), the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(2) as to investments the bid and asked prices of which are not published on a regular basis in a recognized pricing service subscribed to by the Trustee, or in The Wall Street Journal or The New York Times, the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service;

(3) as to certificates of deposit and bankers acceptances, the face amount thereof, plus accrued interest; and

(4) as to any investment not specified above, the value thereof established by prior agreement between the Corporation and the Trustee (with Written Notice to each Rating Agency).

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.

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

Pursuant to the Indenture, the Corporation will establish the Unpledged TSRs Account. The Unpledged TSRs Account 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 Account, any Collections after all Bonds are Fully Paid, and any Unpledged TSRs. This Account will be held by the Corporation and is not pledged to the Trustee for the benefit of the Owners. All amounts held in this account will be transferred to the SPE except that no transfer will occur prior to December 6, 2006.

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 and the execution of Swap Contracts by the counterparties thereto, the provisions of the Indenture will be a part of the contract of the Corporation with the Owners and such counterparties. 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 and such counterparties. 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 and Swap Contracts, 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

Covenant to Pay. The Corporation will pay its Operating Expenses to the parties entitled thereto, to the extent that funds are available therefor, but solely to the extent provided in the Indenture. Termination Payments will be made only from the Operating Contingency Account.

Officer's Certificate with respect to Operating Expenses. On or before April 1 of each year during which Bonds are Outstanding, the Corporation will deliver an Officer's Certificate to the Trustee estimating the Operating Expenses and the Tax Obligations that will be incurred or paid by the Corporation during the next succeeding twelve-month period commencing on July 1. The Officer's Certificate may also set forth Operating Expenses that have already been incurred by the Corporation but that have not yet been paid, provided that the Operating Cap will nonetheless continue to apply to all such amounts. The Corporation may at any time submit a supplemental Officer's Certificate setting forth Operating Expenses in excess of the Operating Cap. Such excess will be deposited in the Operating Contingency Account pursuant to the Indenture if, but only if, all of the deposits required by certain sections of the Indenture have been fully funded.

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 Corporation Tax Certificate, which provisions are incorporated by this reference in the Indenture. 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 and Swap Contract Information

The Corporation will (1) as specified in the Indenture, 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; and (2) annually, within 210 days after the close of each Fiscal Year, deliver to the Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants. The Corporation will further report to the Rating Agencies on an annual basis, but only to the extent that such information is not included in the Corporation's financial statements, (a) the amounts and, to the extent available, the types of payments constituting Pledged TSRs that were received during the preceding Fiscal Year, and (b) whether, to the knowledge of the Corporation, any litigation is then pending against the State or the Corporation seeking to invalidate or overturn the MSA, the Consent Decree, the Agreement or the proceedings pursuant to which the Bonds are issued.

The Corporation will provide to the Trustee copies of all Swap Contracts and related information and schedules of payments thereunder as the Trustee may reasonably request for it to perform its duties under the Indenture.

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 Rating Agencies 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 Subordinate 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:

(1) 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;

(2) immediately after giving effect to such transaction, no Event of Default has occurred and is continuing under the Indenture;

(3) the Corporation has received a Rating Confirmation;

(4) 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;

(5) any action as is necessary to maintain the security interest created by the Indenture has been taken; and

(6) 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.

Swap Contracts. The Corporation will not enter into any Swap Contract until it has first obtained a Rating Confirmation with respect to such Swap Contract, nor will it enter into any Swap Contract unless such Swap Contract provides that any payments to be made to or for the benefit of the Corporation will be made to the Trustee for deposit into the Collections Account.

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.

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, by and among the Corporation, Wilmington Trust Company, as Delaware Trustee and Mark Page, as Trustee and Michael A. Cardozo, as Trustee) 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 Agencies. 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 Agencies and will be removed if rated below investment grade by the Rating Agencies and each successor Trustee will have an investment grade rating from the Rating Agencies. 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 Agencies 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, including the amount on deposit in the Partial Lump Sum Payment Account; and

(e) whether the amount on deposit in the Liquidity Reserve Account is sufficient to satisfy the 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:

(1) failure to pay when due any Swap Payment or interest on any Bonds;

(2) failure to pay any Serial Maturity or Turbo Term Bond Maturity;

(3) failure of the Corporation to observe or perform any other covenant, condition, agreement, or provision contained in the Bonds or in the Indenture 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

(4) 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 within said 60-day period and diligently pursued until the default is corrected; and

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 (1) or (2) 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 (3) or (4) 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.

(4) Upon the occurrence of any Event of Default, the Bonds and Swap Payments will be paid on a Pro Rata basis as described in the Indenture..

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 that 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 2006-1 Bonds, Refunding Bonds, Additional Bonds and Subordinate 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 Agencies and the written consent of a Majority in Interest of the Bonds to be Outstanding at the effective date thereof and affected thereby; 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.

APPENDIX G

BOOK-ENTRY ONLY SYSTEM

*The information in this Appendix G concerning The Depository Trust Company (“**DTC**”), New York, New York, and DTC’s book-entry system has been obtained from DTC and TSASC, the City, the State and the Underwriters take no responsibility for the completeness or accuracy thereof. TSASC, the City, the State and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix G. The current “Rules” applicable to DTC are on file with the Securities and Exchange Commission and the current “Procedures” of DTC to be followed in dealing with DTC Participants are on file with DTC.*

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for the Bonds, in the aggregate initial principal amount of such Bonds, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC’s participants (“**Direct Participants**”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“**DTCC**”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (respectively, “**NSCC**,” “**GSCC**,” “**MBSCC**,” and “**EMCC**,” also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“**Indirect Participants**”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds 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 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of the Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC 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. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Bonds by TSASC will reduce the outstanding principal amount of Bonds held by DTC. In such event, DTC will implement, through its book-entry system, redemption by lot of interests in the Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement redemption of the Bonds for the Beneficial Owners.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer 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 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest evidenced by the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from TSASC or the Indenture Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Indenture Trustee, or TSASC, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal of and interest evidenced by the Bonds 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.

NONE OF TSASC, THE UNDERWRITERS OR THE INDENTURE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Bonds 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. The Agency may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply.

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APPENDIX H

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