NEW ISSUE—BOOK-ENTRY ONLY **See "RATINGS" herein**

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2006 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the Series 2006 Bonds is not a specific preference item for purposes of federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006 Bonds. See "TAX MATTERS" herein.

$583,630,660.45
TOBACCO SECURITIZATION AUTHORITY OF SOUTHERN CALIFORNIA
Tobacco Settlement Asset-Backed Bonds
(San Diego County Tobacco Asset Securitization Corporation)

$534,610,000.00
Series 2006A Senior Current Interest Bonds

$19,769,609.60	$8,685,657.00	$20,565,393.85
Series 2006B First Subordinate CABs	**Series 2006C Second Subordinate CABs**	**Series 2006D Third Subordinate CABs**

Dated Date: Date of Delivery **Due: as shown on inside cover**

The Tobacco Securitization Authority of Southern California (the **"Authority"**) is a public entity created pursuant to a Joint Exercise of Powers Agreement, dated as of September 19, 2001, as amended and restated, by and between the County of San Diego, California (the **"County"**) and the County of Sacramento (each, a **"Local Agency"**). The Authority is a separate entity from the County and its other Local Agency. The Authority's debts, liabilities and obligations do not constitute debts, liabilities or obligations of the County or the other Local Agency. See "THE AUTHORITY" herein.

The Authority's **"Series 2006 Bonds"** consist of the **"Series 2006A Senior Current Interest Bonds,"** the **"Series 2006B First Subordinate CABs"**, the **"Series 2006C Second Subordinate CABs"**, and the **"Series 2006D Third Subordinate CABs."** The Series 2006 Bonds are to be issued pursuant to an Indenture, as supplemented by a Series Supplement, each dated as of May 1, 2006 (the **"Indenture"**), between the Authority and The Bank of New York Trust Company, N.A., as indenture trustee (the **"Trustee"**). The Series 2006A Senior Current Interest Bonds (the "Series 2006 Senior Bonds") and any Additional Bonds hereinafter issued pursuant to the Indenture as Senior Bonds (the **"Senior Bonds"**) are collectively referred to herein as the "Senior Bonds." The Indenture also permits the issuance of Additional Bonds that are First Subordinate Bonds, Second Subordinate Bonds and Third Subordinate Bonds, as well as Additional Subordinate Bonds, all as defined and described herein.

The San Diego County Tobacco Asset Securitization Corporation, a California nonprofit public benefit corporation (the **"Borrower"**) previously purchased all of the right, title and interest of the County in and to the payments required to be made after January 4, 2002, to the State of California (the **"State"**) under the Master Settlement Agreement entered into on November 23, 1998 (the **"MSA"**), by participating cigarette manufacturers (the **"PMs"**), 46 states (including the State) and six other U.S. jurisdictions, in settlement of certain cigarette smoking-related litigation, and made payable to the County pursuant to a Memorandum of Understanding among the State, various California cities and counties and certain other parties, and the Agreement Regarding Interpretation of Memorandum of Understanding among the State, all counties and certain cities within the State (such payments, as more fully described herein, are referred to as **"County Tobacco Assets"**). The Borrower purchased the County Tobacco Assets by means of a loan to the Borrower of the proceeds of the Authority's Tobacco Settlement Asset-Backed Bonds, Series 2001A and Series 2001B (San Diego County Tobacco Asset Securitization Corporation) (collectively, the **"2001 Bonds"**).

The proceeds of the Series 2006 Bonds will be loaned to the Borrower pursuant to a Secured Loan Agreement, dated as of May 1, 2006 (the **"Loan Agreement"**), between the Authority and the Borrower. The Borrower will apply the loan proceeds, together with other available funds, to (i) refund all of the Authority's outstanding 2001 Bonds; (ii) fund a Senior Liquidity Reserve Account for the Series 2006 Senior Bonds; (iii) make a deposit into the Capitalized Interest Subaccount established under the Indenture; (iv) make a deposit into the Operating Account established by the Indenture, and (v) pay the costs of issuance incurred in connection with the issuance of the Series 2006 Bonds. In addition, the County has requested that the Borrower make a grant to the County to be used for the benefit of the County and its residents and the Borrower has approved such request.

The amount of County Tobacco Assets received is dependent on many factors, including future cigarette consumption, the financial capability of the PMs and adjustments to their payment obligations under the MSA as well as litigation affecting the MSA, related state legislation and state enforcement thereof and the tobacco industry. Payments by the PMs under the MSA are subject to certain adjustments, some of which may be material. Bondholders should assume that future annual payments and strategic contribution fund payments may be reduced. See "RISK FACTORS" herein.

Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River*, in which the Attorney General of the State is a defendant, and *Freedom Holdings*, both discussed in "RISK FACTORS" herein), that are pending in the U.S. District Court for the Southern District of New York. The court in the *Grand River* and *Freedom Holdings* actions is considering plaintiffs' allegations of an illegal output cartel under the federal antitrust laws and plaintiffs' allegations of violations under the Commerce Clause of the U.S. 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 County Tobacco Assets available to the Authority to make payments with respect to the Series 2006 Bonds, including payments of Turbo Redemptions (herein defined), interest on or principal or Accreted Value of the Series 2006 Bonds, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

The Series 2006 Bonds are limited obligations of the Authority, payable solely from certain funds held under the Indenture, including payments of TSRs (as defined herein), and earnings on such funds (the "Collections"). The Series 2006 Bonds are not secured by the proceeds thereof, with the exception of the proceeds deposited in the Senior Liquidity Reserve Account and the Capitalized Interest Subaccount which only secure Senior Bonds. The Bonds (as defined herein) do not constitute a charge against the general credit of the Authority and under no circumstances will the Authority be obligated to pay Turbo Redemptions, interest on or principal or Accreted Value of or redemption premiums, if any, on the Bonds except from Collections and balances held in the Senior Liquidity Reserve Account (where applicable, and to the extent available). The Bonds and other obligations of the Authority are not a debt or obligation of the State or any of its municipalities or other political subdivisions, other than the Authority, and neither the State nor any such municipalities or other subdivisions, other than the Authority, shall be liable for the payment of Turbo Redemptions, interest on or principal or Accreted Value of the Bonds or such other obligations. The Authority has no taxing power.

The Series 2006 Bonds do not constitute a charge against the general credit of the Authority or any of its Local Agencies, including the County, and under no circumstances shall the Authority or any Local Agency, including the County, be obligated to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds, except from the Collateral pledged therefor under the Indenture. Neither the credit of the State, nor any public agency of the State (other than the Authority), nor any Local Agency of the Authority, including the County, is pledged to the payment of the Series 2006 Bonds. The Series 2006 Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Authority) or any Local Agency of the Authority, including the County. The County is under no obligation to make any payments on the Series 2006 Bonds.

Interest on the Series 2006A Senior Current Interest Bonds is payable on June 1 and December 1 of each year (each a **"Distribution Date"**), commencing on December 1, 2006. Interest on the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs is not paid currently but is compounded on each Distribution Date (to become part of Accreted Value as more fully described herein), until such Bonds are redeemed or paid.

All of the Series 2006 Bonds are expected to be issued as Turbo Term Bonds (as defined herein). The Series 2006 Bonds are subject to redemption in accordance with the schedule of Sinking Fund Installments where applicable and payment on the related Turbo Term Bond Maturity Dates (as defined herein). The Authority has covenanted to apply all Surplus Collections (as defined herein) to pay Turbo Redemptions of the Series 2006 Bonds in accordance with their Payment Priorities (as defined herein). As a consequence, it is expected that payment of principal or Accreted Value of the Series 2006 Bonds will be substantially earlier than the scheduled Sinking Fund Installments where applicable and Turbo Term Bond Maturities therefor. No payments will be made with respect to the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs before the Senior Bonds are paid or redeemed in full. No payments will be made with respect to the Series 2006C Second Subordinate CABs or the Series 2006D Third Subordinate CABs before the Senior Bonds and the Series 2006B First Subordinate CABs are paid or redeemed in full. No payments will be made with respect to the Series 2006D Third Subordinate CABs before the Senior Bonds, the Series 2006B First Subordinate CABs and the Series 2006C Second Subordinate CABs are paid or redeemed in full.

A failure by the Authority to pay interest on or principal, or Accreted Value, as applicable, of the Senior Bonds, when due, will constitute an Event of Default under the Indenture. A failure by the Authority to pay Accreted Value of the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, the Series 2006D Third Subordinate CABs or any Additional Subordinate Bonds, when due, will not constitute an Event of Default under the Indenture, but will result in a Subordinate Payment Default (as defined herein), which gives rise to certain rights and remedies after Senior Bonds are no longer Outstanding. Failure to pay Sinking Fund Installments where applicable or Turbo Redemptions on Turbo Term Bonds will not constitute an Event of Default or a Subordinate Payment Default under the Indenture. **The ratings for the Series 2006 Bonds address only (i) the payment of interest on the Series 2006 Bonds, when due, and (ii) the payment of principal or Accreted Value of Series 2006 Bonds by their Maturity Dates. The ratings do not address the payment of Sinking Fund Installments on Series 2006 Bonds or Turbo Redemptions. See "RATINGS" herein.**

The Series 2006 Bonds are subject to redemption, including sinking fund redemption, Turbo Redemption, optional redemption, mandatory clean-up call, and extraordinary prepayment, all as described herein.

The Series 2006 Bonds are being reoffered only in Authorized Denominations (as defined herein). Upon purchase of any of the Series 2006D Third Subordinate CABs, a purchaser will be deemed to have represented that it is a Qualified Institutional Buyer and that it has holdings amounting to at least $1,000,000 in Accreted Value at Maturity Date of Series 2006 Bonds that are not currently rated in an Investment Grade rating category by at least one nationally recognized rating agency; provided, however, that these restrictions on the transfer or purchase of the Series 2006D Third Subordinate CABs shall not be applicable at such time as the Series 2006D Third Subordinate CABs are assigned a rating in an "investment grade" rating category by at least one nationally recognized rating agency. See "RISK FACTORS – Limitations on Transferability" herein.

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

See Inside Front Cover for Maturity Schedule.
Principal Amounts, Interest Rates, Prices, Yields, Projected Turbo Redemption Dates and Average Lives

---

This cover page contains information for quick reference only. It is not a summary of this issue. Investors must read the entire Offering Circular to obtain information essential to making an informed investment decision.

The Series 2006 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of validity by Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, as Bond Counsel to the Authority. Certain legal matters with respect to the Authority, the Borrower and the County will be passed upon by County Counsel and Orrick, Herrington & Sutcliffe LLP. Certain legal matters will be passed upon for the Underwriters by their counsel, Hawkins Delafield & Wood LLP, Los Angeles, California. It is expected that the Series 2006 Bonds will be available for delivery in book-entry form only through the facilities of The Depository Trust Company, New York, New York on or about May 31, 2006.

Bear, Stearns & Co. Inc.

Citigroup **Goldman, Sachs & Co.**
Merrill Lynch & Co. **Siebert Brandford Shank & Co., LLC**

Date: May 26, 2006

$583,630,660.45

TOBACCO SECURITIZATION AUTHORITY OF SOUTHERN CALIFORNIA
Tobacco Settlement Asset-Backed Bonds
(San Diego County Tobacco Asset Securitization Corporation)

MATURITY SCHEDULE

$534,610,000
Series 2006A Senior Current Interest Bonds
(Turbo Term Bonds)

$111,860,000	4.75%	Turbo Term Bonds due June 1, 2025	Yield 4.85%

Projected Final Turbo Redemption Date: June 1, 2016*
Projected Average Life: 5.9 years*
CUSIP† 888804AW1

$186,440,000	5.00%	Turbo Term Bonds due June 1, 2037	Yield 5.30%

Projected Final Turbo Redemption Date: June 1, 2024*
Projected Average Life: 14.5 years*
CUSIP† 888804AX9

$236,310,000	5.125%	Turbo Term Bonds due June 1, 2046	Yield 5.40%

Projected Final Turbo Redemption Date: June 1, 2029 *
Projected Average Life: 21.1 years*
CUSIP† 888804AY7

* Assumes Turbo Redemptions are made based on the receipt of 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.

† CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2006 Bonds and none of the County, the Authority, the Borrower or the Underwriter can 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 Bonds as a result of 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 Bonds.

MATURITY SCHEDULE
(Continued)

$19,769,609.60
Series 2006B First Subordinate CABs
(Turbo Term Bonds)

Maturity Date (June 1)	Initial Principal Amount	Initial Principal Amount per $5,000 Accreted Value at Maturity Date	Maturity Value*	Approximate Yield to Maturity Date	Projected Final Turbo Redemption Date**	Projected Average Life**	CUSIP†
2046	$19,769,609.60	$426.40	$231,820,000	6.25%	June 1, 2031	24.3	888804AZ4

$8,685,657.00
Series 2006C Second Subordinate CABs
(Turbo Term Bonds)

Maturity Date (June 1)	Initial Principal Amount	Initial Principal Amount per $5,000 Accreted Value at Maturity Date	Maturity Value*	Approximate Yield to Maturity Date	Projected Final Turbo Redemption Date**	Projected Average Life**	CUSIP†
2046	$8,685,657.00	$402.30	$107,950,000	6.40%	June 1, 2032	25.7	888804BA8

$20,565,393.85
Series 2006D Third Subordinate CABs
(Turbo Term Bonds)

Maturity Date (June 1)	Initial Principal Amount	Initial Principal Amount per $5,000 Accreted Value at Maturity Date	Maturity Value*	Approximate Yield to Maturity Date	Projected Final Turbo Redemption Date**	Projected Average Life**	CUSIP†
2046	$20,565,393.85	$306.85	$335,105,000	7.10%	June 1, 2035	27.6	888804BB6

* Represents Accreted Value at the Maturity Date. However, Turbo Redemptions will be made in accordance with the Payment Priorities (as defined herein) to the extent of available Surplus Collections (as defined herein) at the Accreted Value calculated as of the Redemption Date.

** Assumes Turbo Redemptions are made based on the receipt of 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.

† CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2006 Bonds and none of the County, the Authority, the Borrower or the Underwriter can 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 Bonds as a result of 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 Bonds.

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

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED IN CONNECTION WITH ANY OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE AUTHORITY, THE BORROWER, THE COUNTY 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 BONDS WILL DEVELOP OR, IF ONE DEVELOPS, THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2006 BONDS.

The information set forth herein has been furnished by the Authority, the Borrower and Global Insight (herein defined) 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 participants and certain other sources. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY." The tobacco industry participants have not provided any information to the Authority, the Borrower or the County for use in connection with this offering. In certain cases, tobacco industry information provided herein (such as market share data) may be derived from sources that are inconsistent or in conflict with each other. The Authority, the Borrower and the County have not independently verified the information under the caption "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY"; the Authority, the Borrower and the County cannot and do not warrant the accuracy or completeness of this information. The information contained under the captions "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" and "GLOBAL INSIGHT POPULATION REPORT" and in the Global Insight Cigarette Consumption Report attached as Appendix A hereto and the Global Insight Population Report attached as Appendix B hereto have been included in reliance upon Global Insight as an expert in econometric forecasting, and has not been independently verified by the Authority, the Borrower, or the County.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority, the Borrower or the County, in the matters covered by the reports of Global Insight attached hereto as Appendix A and Appendix B 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 Collections (herein defined) (see "RISK FACTORS," "LEGAL CONSIDERATIONS," "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT," "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT," "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" and "GLOBAL INSIGHT POPULATION REPORT"), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Authority, the Borrower, the County, Global Insight or the Underwriters that such forecasts, projections and estimates will

occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

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

THE SERIES 2006 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE U.S. 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.

(THIS PAGE INTENTIONALLY LEFT BLANK)

TOBACCO SECURITIZATION AUTHORITY OF SOUTHERN CALIFORNIA

Board of Directors

Bill Horn, *Chair*

Susan Peters, *Vice Chair*

Greg Cox, *Member*

SAN DIEGO COUNTY TOBACCO ASSET SECURITIZATION CORPORATION

Board of Directors

Dan McAllister , *Chair*

Donald F. Steuer, *Chief Financial Officer*

Michel Anderson, *Secretary*

SPECIAL SERVICES

Bond Counsel
Orrick, Herrington & Sutcliffe LLP
Los Angeles, California

Trustee
The Bank of New York Trust Company, N.A.
Los Angeles, California

Underwriters' Counsel
Hawkins Delafield & Wood LLP
Los Angeles, California

Financial Advisor
Public Resources Advisory Group
Los Angeles, California

(THIS PAGE INTENTIONALLY LEFT BLANK)

TABLE OF CONTENTS

(THIS PAGE INTENTIONALLY LEFT BLANK)

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 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 or Purchase and Sale Agreement, as applicable. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Definitions" attached hereto.

Overview..... The Tobacco Securitization Authority of Southern California (the "**Authority**") is issuing its Series 2006 Bonds (as defined herein) to fund the Authority's loan to the San Diego County Tobacco Asset Securitization Corporation, a California nonprofit public benefit corporation (the "**Borrower**"), pursuant to a Secured Loan Agreement, dated as of May 1, 2006 (the "**Loan Agreement**"), between the Authority and the Borrower. The Series 2006 Bonds will be issued pursuant to an Indenture, as supplemented by a Series Supplement, each dated as of May 1, 2006 (collectively, the "**Indenture**"), between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "**Trustee**").

The Series 2006 Bonds are primarily secured by a portion of tobacco settlement revenues ("**TSRs**") required to be paid to the State of California (the "**State**") under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs**"), 46 states and six other U.S. jurisdictions, in November 1998 in settlement of certain cigarette smoking-related litigation and made payable to the County of San Diego (the "**County**") pursuant to agreements with the State and other parties. See "SECURITY FOR THE SERIES 2006 BONDS" herein. The "County Tobacco Assets" are the right, title and interest of the County in, to and under the MSA and the Memorandum of Understanding (the "**MOU**"), as agreed to by the State and the Participating Jurisdictions (described below), as provided in the Agreement Regarding Interpretation of Memorandum of Understanding (the "**ARIMOU**") and the Consent Decree (as defined herein) including the County's share of Initial Payments, Annual Payments and Strategic Contribution Fund Payments received from and after January 4, 2002. The County sold the County Tobacco Assets to the Borrower pursuant to a Purchase and Sale Agreement dated as of December 1, 2001, by and between the County and the Borrower (the "**Purchase and Sale Agreement**"). The Purchase and Sale Agreement remains in full force and effect.

The Borrower purchased the County Tobacco Assets by means of a loan of the proceeds of the Authority's Tobacco Settlement Asset-Backed Bonds, Series 2001A and 2001B (the "**2001 Bonds**"). A portion of the proceeds of the Series 2006 Bonds will be used to advance refund all of the outstanding 2001 Bonds. See "PLAN OF REFUNDING" and "ESTIMATED SOURCES AND USES OF FUNDS" herein.

Use of Proceeds	The proceeds of the Series 2006 Bonds will be loaned to the Borrower pursuant to the Loan Agreement between the Authority and the Borrower. The Borrower will apply the loan proceeds, together with other available funds, to (i) refund all of the Authority's outstanding 2001 Bonds; (ii) fund a Senior Liquidity Reserve Account for the Series 2006 Senior Bonds (the "**Senior Liquidity Reserve Account**"); (iii) make a deposit into the Capitalized Interest Subaccount established under the Indenture (the "**Capitalized Interest Subaccount**"), (iv) make a deposit into the Operating Account established by the Indenture (the "**Operating Account**"), and (v) pay the costs of issuance incurred in connection with the issuance of the Series 2006 Bonds. In addition, the County has requested that the Borrower make a grant to the County to be used for the benefit of the County and its residents and the Borrower has approved such request.
The Authority	The Authority is a public entity created by a Joint Exercise of Powers Agreement, dated as of September 19, 2001, as amended and restated, by and between the County and the County of Sacramento (each, a "**Local Agency**"). The Authority is a separate entity from the Local Agencies and its debts, liabilities and obligations do not constitute debts, liabilities and obligations of the Local Agencies. The Series 2006 Bonds do not constitute a charge against the general credit of the Authority or any of its Local Agencies, including the County, and under no circumstances shall the Authority or any Local Agency, including the County, be obligated to pay Turbo Redemptions, interest on and principal or Accreted Value of the Series 2006 Bonds, except from the Collateral pledged therefor under the Indenture. Neither the credit of the State, nor any public agency of the State (other than the Authority), nor any Local Agency of the Authority, including the County, is pledged to the payment of the Series 2006 Bonds. The Series 2006 Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Authority) or any Local Agency of the Authority, including the County. The County is under no obligation to make any payments on the Series 2006 Bonds.
The Borrower	The Borrower is a special purpose nonprofit public benefit corporation organized under the California Nonprofit Public Benefit Corporation Law.
The County	The County of San Diego is a political subdivision in the State of California and is a separate entity from the Authority and the Borrower.
Litigation Regarding MSA and Related Statutes	Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River*, in which the Attorney General of the State is a defendant, and *Freedom Holdings*, discussed in "RISK FACTORS" herein), that are pending in the U.S. 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 and that state statutes enacted pursuant to the MSA

violate the Commerce Clause of the U.S. 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 TSRs available to the Authority to make payments with respect to the Series 2006 Bonds, including payments of Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

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 U.S. tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**"). Philip Morris, Reynolds Tobacco, B&W and Lorillard are collectively referred to as the "**Original Participating Manufacturers**" or the "**OPMs**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. References herein to the "Original Participating Manufacturers" or "OPMs" means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively Philip Morris, Reynolds American and Lorillard. As reported by the OPMs, the OPMs accounted for approximately 86.1%† of the U.S. domestic cigarette market in 2005, 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 Initial Payments, Annual Payments and Strategic Contribution Fund Payments as defined

---

† Market share information for the OPMs based on domestic industry shipments may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of OPMs to contribute to Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - Annual Payments" herein. 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 as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" herein. The aggregate market share information used in the Cash Flow Assumptions may differ materially from the market share information used by MSA Auditor in calculating the adjustments to Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - Adjustments to Payments" herein.

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. The Authority, the Borrower and the County are not parties 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.**" Under the MSA, the State is entitled to 12.7639554% of the Initial Payments and Annual Payments and 5.1730408% of the Strategic Contribution Fund Payments made by PMs under the MSA and distributed through the National Escrow Agreement, entered into on December 23, 1998 (the "**National Escrow Agreement**"), among the Settling States, the OPMs and Citibank, N.A., as escrow agent thereunder (the "**MSA Escrow Agent**").

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

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

and (iii) ten annual payments in the amount of $861 million each, each of which is subject to adjustment (the "**Strategic Contribution Fund**

† As described herein, the base amounts of Annual Payments are subject to various adjustments which have resulted in reduced annual payments in certain prior years. See "SUMMARY OF MASTER SETTLEMENT AGREEMENT - Annual Payments" and "RISK FACTORS - Other Potential Payment Decreases Under the Terms of the MSA - *Disputed or Recalculated Payments and Disputes under the Terms of the MSA*" herein.

Payments"), required to be made on each April 15 commencing April 15, 2008 and ending April 15, 2017.

See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Initial Payment," "– Annual Payments" and "– Strategic Contribution Fund Payments" herein.

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and Strategic Contribution Fund Payment based on its respective market share of the U.S. cigarette market during the preceding calendar year, in each case, subject to certain adjustments as described herein. Each SPM has Annual Payment and Strategic Contribution Fund Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share. The SPMs have no payment obligation with respect to the Initial Payments under the MSA. The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent, which is required, in turn, pursuant to the instructions of the MSA Escrow Agreement, to remit an allocable share of such payments to the parties entitled thereto.

Under the MSA, the Annual Payments and Strategic Contribution Fund Payments due under the MSA are subject to numerous adjustments, some of which may be material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions for decreases in market share of PMs under certain circumstances, reductions on account of 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 in the case of the Annual Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - Adjustments to Payments" and "RISK FACTORS - Other Potential Payment Decreases Under the Terms of the MSA - *NPM Adjustment*" and "*Disputed or Recalculated Payments and Disputes under the Terms of the MSA*" herein. The share of the TSRs constituting the County Tobacco Assets is further subject to reductions or increases to account for changes in the relative population of the County. See "RISK FACTORS – Potential Payment Adjustments under the MOU and the ARIMOU" herein.

Flow of TSR Payments..... When the County Tobacco Assets were sold to the Borrower in connection with the issuance of the 2001 Bonds, the California Escrow Agent (defined below) was irrevocably instructed by the County to disburse the County Tobacco Assets from the California Local Government Escrow Account (defined below) directly to the trustee for the 2001 Bonds. In connection with the issuance of the Series 2006 Bonds, the California Escrow Agent will be irrevocably instructed by the County to disburse the County Tobacco Assets from the California Local Government Escrow Account directly to the Trustee. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT - Flow of Funds and California Escrow Agreement" herein.

The California Consent Decree, the MOU, the ARIMOU and the California Escrow Agreement.....

On December 9, 1998, the Consent Decree and Final Judgment (the "**Consent Decree**") that governs the class action portion of the State's action against the tobacco companies was entered in the Superior Court of the State of California for San Diego County. The Consent Decree, which is final and non-appealable, settled the class action litigation brought by the State against the OPMs and resulted in the achievement of California State-Specific Finality under the MSA.

Prior to the entering of the Consent Decree, the plaintiffs of certain pending cases agreed, among other things, to coordinate their pending cases and to allocate certain portions of the recovery among the State, its 58 counties (including the City and County of San Francisco), the Cities of San Jose, Los Angeles, San Diego and San Francisco (the "**Participating Jurisdictions**"). This agreement was memorialized in the MOU, by and among counsel representing the State and various counsel representing a number of the Participating Jurisdictions. Upon satisfying certain conditions set forth in the MOU and the ARIMOU, the Participating Jurisdictions are deemed to be "eligible" to receive a share of the Initial Payments, Annual Payments and Strategic Contribution Fund Payments, representing the TSRs, to which the State is entitled under the MSA. All of the Participating Jurisdictions under the MOU and the ARIMOU, including the County, have satisfied the conditions of the MOU and the ARIMOU and are eligible to receive their portion of the TSRs to which the State is entitled under the MSA.

Under the MOU, 45% of the State's entire allocation of TSRs under the MSA are allocated to the Participating Jurisdictions, which are the State's 58 counties (including the City and County of San Francisco), 5% to the four cities (including the City and County of San Francisco, which receives payments in both capacities) that are Participating Jurisdictions (1.25% each), with the remaining 50% being retained by the State. The counties' 45% share is allocated based on population, on a per capita basis as reported in the 1990 Official U.S. Decennial Census, as adjusted by the 2000 Official U.S. Decennial Census. Pursuant to the proportional allocable share provided in the MOU and the ARIMOU, based on adjustments made to reflect the 2000 official U.S. Decennial Census, the County is currently entitled to receive approximately 3.738% of the total Statewide share of the TSRs. This percentage is subject to adjustments for population changes every ten years based on the U.S. Decennial Census as described herein. The TSRs are subject to several adjustments as described herein. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT" herein.

To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU among the State and the Participating Jurisdictions, the parties entered into the ARIMOU.

Under the MSA, the State's portion of the TSRs are deposited into the California State-Specific Account held by Citibank, N.A., as MSA Escrow Agent. Pursuant to the terms of the MOU, the ARIMOU and an Escrow Agreement dated April 12, 2000, as amended by the first amendment to escrow agreement, dated July 19, 2001 (the "**California Escrow Agreement**") between the State and Citibank, N.A., as California Escrow Agent (the "**California Escrow Agent**"), the State has instructed the MSA Escrow Agent to transfer (upon receipt thereof) all amounts in the California State-Specific Account to the California Escrow Agent. The California Escrow Agent is required to deposit the State's 50% share of the TSRs in an account for the benefit of the State, and the remaining 50% of the TSRs into separate sub-accounts of an account for the benefit of the Participating Jurisdictions or as otherwise directed by the local jurisdiction (this account referred to herein as the "**California Local Government Escrow Account**"). Upon the sale of the County Tobacco Assets to the Borrower on January 4, 2002, the California Escrow Agent was irrevocably instructed by the County to disburse the County Tobacco Assets from the California Local Government Escrow Account directly to the trustee for the 2001 Bonds. In connection with the issuance of the Series 2006 Bonds, the California Escrow Agent will be irrevocably instructed by the County to disburse the County Tobacco Assets from the California Local Government Escrow Account directly to the Trustee. The MOU provides that the distribution of tobacco related recoveries is not subject to alteration by legislative, judicial or executive action at any level, and, if such alteration were to occur and survive legal challenge, any modification would be borne proportionally by the State and the Participating Jurisdictions. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT" herein.

Sale of TSRs ..... The County previously sold its right, title and interest in, to and under the MSA, the MOU, the ARIMOU and the Consent Decree, including the County's share of Initial Payments, Annual Payments and Strategic Contribution Fund Payments received from and after January 4, 2002 (collectively, the "County Tobacco Assets"), to the Borrower pursuant to the Purchase and Sale Agreement. The Purchase and Sale Agreement remains in full force and effect upon and after the issuance of the Series 2006 Bonds. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

Industry Overview ..... The three OPMs (Philip Morris, Reynolds American and Lorillard) are the largest manufacturers of cigarettes in the U.S., based on 2005 domestic market share. The market for cigarettes is highly competitive and is characterized by brand recognition and loyalty. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" herein.

Cigarette Consumption ..... As described in the Global Insight Cigarette Consumption Report referred to 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, reaching a level of 465 billion cigarettes in 1998, and decreased to an estimated 381

billion cigarettes in 2005. 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 CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

Global Insight Cigarette Consumption Report..... Global Insight Inc. ("**Global Insight**"), an international econometric and consulting firm, was retained on behalf of the Authority to forecast cigarette consumption in the United States from 2004 through 2046. Global Insight's report, entitled "A Forecast of U.S. Cigarette Consumption (2004-2046) for Tobacco Securitization Authority of Southern California" dated May 26, 2006 (the "**Global Insight Cigarette 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 Cigarette Consumption Report is subject to certain disclaimers and qualifications as described therein. See Appendix A – "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

Global Insight considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. Global Insight found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places and the trend over time in individual behavior and preferences. Using data from 1965 to 2003 and an analysis of the variables, Global Insight constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the U.S. 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 2046.

While the Global Insight Cigarette Consumption Report is based on U.S. cigarette consumption, MSA Payments are computed based in part on shipments in or to the fifty states, the District of Columbia and Puerto Rico. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the U.S. 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 CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto. The projections and forecasts regarding future cigarette consumption included in the Global Insight Cigarette

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.

Global Insight Population Report .... Global Insight has also prepared a report entitled "A Forecast of Population (2000-2040) for Counties in California including San Diego County" dated May 26, 2006 (the "**Global Insight Population Report**"). The Global Insight Population Report is attached hereto as Appendix B 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 Population Report is subject to certain disclaimers and qualifications as described therein. See Appendix B – "GLOBAL INSIGHT POPULATION REPORT" attached hereto.

The Global Insight Population Report forecasts the percentage of total residents in the State who will reside in the County from 2000 through 2040. Global Insight found the following variables to be relevant in building an empirical model of California population through 2040 by county and share of the total population: births, deaths, and migration (international, domestic and county to county). The projections and forecasts are based on assumptions regarding the future paths of these factors, as further described in the Global Insight Population Report. See "GLOBAL INSIGHT POPULATION REPORT" herein. 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.

Collateral..... The Series 2006 Bonds will be secured by the Authority's rights with respect to the Loan Agreement, the Corporation Tobacco Assets (as defined below) and certain moneys under the Indenture and such other assets and property described in the Indenture (the "**Collateral**").

Loan Agreement ..... Pursuant to the Loan Agreement, the Borrower has pledged and assigned and granted a security interest in all right, title and interest of the Borrower in, to and under the following property, whether now owned or hereafter acquired: (a) the County Tobacco Assets purchased from the County, (b) to the extent permitted by law (as to which no representation is made) corresponding present or future rights, if any, of the Borrower to enforce or cause the enforcement of payment of such purchased County Tobacco Assets pursuant to the MOU and the ARIMOU, (c) the corresponding rights of the Borrower under the Purchase and Sale Agreement, and (d) all proceeds of any and all of the foregoing (collectively, the "**Corporation Tobacco Assets**").

Securities Offered ..... The "**Series 2006 Bonds**" consist of the "**Series 2006A Senior Current Interest Bonds**," the "**Series 2006B First Subordinate CABs**", the "**Series 2006C Second Subordinate CABs**" and the "**Series 2006D Third Subordinate CABs**." The Series 2006 Bonds will mature on the dates and bear or accrete interest at the respective rates per annum as described on the inside cover page of this Offering Circular and will be offered in Authorized Denominations. "**Authorized Denominations**" means: (1) with respect to the Series

2006A Bonds, $5,000 or any integral multiple thereof; (2) with respect to the Series 2006B First Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $5,000 or any integral multiple thereof; (3) with respect to the Series 2006C Second Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $5,000 or any integral multiple thereof, and (4) with respect to the Series 2006D Third Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $100,000 or any integral multiple of $5,000 in excess thereof. It is expected that the Series 2006 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about May 31, 2006 (the "**Closing Date**"). Individual purchases of beneficial ownership interests may be made only in Authorized Denominations. Beneficial owners of the Series 2006 Bonds will not receive physical delivery of bond certificates. See APPENDIX G - "Book-Entry Only System" attached hereto.

The Series 2006A Senior Current Interest Bonds (the "**Series 2006 Senior Bonds**") and any Additional Bonds hereinafter issued pursuant to the Indenture as Senior Bonds (the "**Senior Additional Bonds**") are collectively referred to herein as the "**Senior Bonds**." The Indenture also permits the issuance of Additional Bonds that are First Subordinate Bonds, Second Subordinate Bonds, and Third Subordinate Bonds, as well as Additional Subordinate Bonds, all as defined and described herein. See "Certain Definitions" below and "THE SERIES 2006 BONDS" herein.

The Series 2006 Bonds are limited obligations of the Authority, payable from and secured solely by the Collateral pledged under the Indenture. The Bondholders have no recourse to other assets of the Authority, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Authority related to its Local Agencies other than the County. Neither the Indenture nor the Series 2006 Bonds create an indebtedness or liability of any Local Agency of the Authority, including the County, or of the State, for any purpose, including any constitutional or statutory limitations. The Authority's revenues are not funds of the County or of any other Local Agency.

Subordination of Series 2006B First Subordinate CABs, Series 2006C Second Subordinate CABs and Series 2006D Third Subordinate CABs.....

No payments will be made with respect to the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, before the Senior Bonds are paid or redeemed in full. No payments will be made with respect to the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, before the Senior Bonds and the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, are paid or redeemed in full. No payments will be made with respect to the Third Subordinate Bonds, including the Series 2006D Third Subordinate CABs, before the Senior Bonds, the First

Subordinate Bonds, including the Series 2006B First Subordinate CABs, and the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, are paid or redeemed in full. Even if there has been a Subordinate Payment Default (as defined herein), the Owners of the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, may not enforce the provisions of the Indenture for their benefit by appropriate legal proceedings unless or until the Senior Bonds are no longer Outstanding. Similarly, (i) the Owners of the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, may not enforce the provisions of the Indenture for their benefit unless or until the Senior Bonds and the First Subordinate Bonds are no longer Outstanding, and (ii) the Owners of the Third Second Subordinate Bonds, including the Series 2006D Third Subordinate CABs, may not enforce the provisions of the Indenture for their benefit unless or until the Senior Bonds, the First Subordinate Bonds and the Second Subordinate Bonds are no longer Outstanding.

Limitations on Transferability ..... The Series 2006D Third Subordinate CABs are rated below investment grade upon their issuance. The Series 2006D Third Subordinate CABs are being reoffered only in Authorized Denominations and may only be resold to "qualified institutional buyers" as such term is defined in Rule 144A under the Securities Act of 1933. In addition, each Owner of a Series 2006D Third Subordinate CAB will be deemed to have represented that at the time of the purchase it has holdings equal to at least $1,000,000 Accreted Value at Maturity Date of Series 2006 Bonds that are not currently rated in an Investment Grade rating category by at least one nationally recognized rating agency; provided, however, that these restrictions on transfer or purchase of the Series 2006D Third Subordinate CABs shall not be applicable at such time as the Series 2006D Third Subordinate CABs are assigned a rating in an "investment grade" rating category by at least one nationally recognized rating agency. Any purchase of such Series 2006D Third Subordinate CABs that does not comport with the representation and agreement deemed to be made pursuant to the Indenture will deprive such Owner or beneficial owner of any right whatsoever to enforce the provisions of the Indenture (any provision of the Indenture to the contrary notwithstanding).

"**Investment Grade**" means a rating category without regard to modifiers from: (i) Moody's Investors Service ("Moody's") of at least Baa; (ii) Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("**S&P**") of at least BBB; or (iii) Fitch Inc. ("**Fitch**") of at least BBB.

Certain Definitions..... The Series 2006A Senior Current Interest Bonds and any Senior Additional Bonds (as defined herein) are collectively referred to herein as "**Senior Bonds**."

"**Additional Bonds**" means Bonds, other than the Series 2006 Bonds and the Additional Subordinate Bonds, issued for refunding or any lawful purpose subject to the conditions set forth in the Indenture.

"**Senior Additional Bonds**" means Senior Bonds issued as Additional Bonds.

"**Additional Subordinate Bonds**" means one or more Series of Bonds issued for any lawful purpose if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid (as defined herein).

"**First Subordinate Bonds**" means the Series 2006B First Subordinate CABs and Additional Bonds identified as First Subordinate Bonds in a Series Supplement.

"**Second Subordinate Bonds**" means the Series 2006C Second Subordinate CABs and Additional Bonds identified as Second Subordinate Bonds in a Series Supplement.

"**Third Subordinate Bonds**" means the Series 2006D Third Subordinate Bonds and Additional Bonds identified as Third Subordinate Bonds in a Series Supplement.

"**Bonds**" means the Series 2006 Bonds, any Additional Bonds and Additional Subordinate Bonds.

"**Current Interest Bond**" means a Bond (including, as the context requires, a Convertible Bond on and after the applicable Conversion Date), the interest on which is payable currently on each Distribution Date.

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

"**Senior Current Interest Bond**" means a Current Interest Bond that is identified as a Senior Bond in a Series Supplement.

"**Capital Appreciation Bond**" means a Bond (including, as the context requires, a Convertible Bond prior to the applicable Conversion Date), the interest on which is compounded on each Distribution Date, commencing on the first Distribution Date after its issuance through (1) and including the Maturity Date or earlier redemption date of such Bond in the case of a Capital Appreciation Bond which is not a Convertible Bond, or (2) and excluding the Conversion Date or including any earlier redemption date in the case of a Convertible Bond.

"**Convertible Bond**" means a Capital Appreciation Bond which is deemed to be a Current Interest Bond after the applicable Conversion Date.

"**Conversion Date**" means the date set forth in the applicable Series Supplement on and after which a Convertible Bond is deemed a Current Interest Bond and after which the Owners shall be entitled to current payments of interest on each Distribution Date.

"**Accreted Value**" means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest accrued thereon from its date, compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through and including the Maturity Date or earlier redemption date of such Bond, or in the case of a Convertible Bond, through and excluding the applicable Conversion Date or through and including any earlier redemption date of such Bond) at the "original issue yield" for such Bond, as set forth in the related Series Supplement or in an exhibit thereto; provided, however, that the Authority shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the related Series Supplement or in an exhibit thereto by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Dates. The term "original issue yield" means, with respect to any particular Bond, the yield to the applicable Maturity Date of such Bond from the initial date of delivery thereof calculated on the basis of semiannual compounding on each Distribution Date.

"**Bond Obligation**" means, as of any given date of calculation, (a) with respect to any Outstanding Current Interest Bond, the principal amount of such Current Interest Bond, and (b) with respect to any Outstanding Capital Appreciation Bond, the Accreted Value thereof as of such date.

Interest ..... The Series 2006 Bonds will bear or accrete interest at the respective rates per annum as described on the inside cover page of this Offering Circular and as further described herein.

Interest on the Series 2006A Senior Current Interest Bonds will be payable on each Distribution Date, as further described herein.

Interest on the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs shall accrete from the dated date thereof and shall be compounded on each Distribution Date, commencing with the first Distribution Date after their issuance through and including the Maturity Date or earlier redemption date of such Bond, as further described herein.

Interest on the Series 2006 Bonds is capitalized through December 1, 2006.

Turbo Term Bonds..... The Series 2006 Bonds are all issued as Turbo Term Bonds. A failure by the Authority to pay interest when due, or any Serial Maturity or Turbo Term Bond Maturity of, any Senior Bond, when due, will constitute an Event of Default under the Indenture. A failure by the Authority to pay the Bond Obligation of the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, the Series 2006D Third Subordinate CABs or any First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds or Additional Subordinate Bonds, by their maturity date, will **not** constitute an Event of Default, but will be a Subordinate Payment Default under the Indenture.

"**Maturity Date**" means, with respect to any Bond, the final date on which all remaining principal or Accreted Value of such Bond is due and payable.

The ratings of the Series 2006 Bonds only address each Rating Agency's assessment of the ability of the Authority to pay interest when due and to pay principal or Accreted Value of the Series 2006 Bonds by their respective Maturity Dates and do not address payment at any earlier time, whether from Turbo Redemptions or Sinking Fund Installments, as described herein or otherwise. See "RATINGS" herein.

Interest, principal or Accreted Value on the Series 2006 Bonds will be paid from Collections in accordance with their Payment Priorities. While the Senior Bonds are outstanding, interest on or any Serial Maturity or Turbo Term Maturity of any Senior Bond will be paid from the Senior Liquidity Reserve Account to the extent that Collections are insufficient therefor.

Sinking Fund Installments ..... "**Sinking Fund Installments**" means each respective payment of principal or Accreted Value to be made on Turbo Term Bonds that are Senior Bonds scheduled to be made from amounts available therefor in the Senior Debt Service Account and the Partial Lump Sum Payment Account, as such schedule is set forth in a Series Supplement. Amounts in the Senior Liquidity Reserve Account are not available to make Sinking Fund Installments. Failure by the Authority to pay the Sinking Fund Installments when such Sinking Fund Installments are due will not constitute an Event of Default under the Indenture to the extent that such failure results from the insufficiency of available Collateral to make such payment therefor.

Turbo Redemptions..... Under the Indenture, 100% of all Collections which are in excess of the requirements for, among other things, the periodic funding of Operating Expenses, interest payments, Sinking Fund Installments, Turbo Term Bond Maturities and replenishment of the Senior Liquidity Reserve Account ("**Surplus Collections**") are applied to the mandatory redemption of the Series 2006 Bonds at the principal amount or Accreted Value thereof on each Distribution Date (or special redemption date under the Indenture) in accordance with the Payment Priorities defined herein ("**Turbo Redemptions**"). Turbo Redemptions may also be made in accordance with the Payment Priorities 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 any Senior Bonds from such Rating Agency will be withdrawn, reduced or suspended. Amounts in the Senior Liquidity Reserve Account are not available to make Turbo Redemptions. The Trustee may specify a special redemption date for purposes of redeeming Turbo Term Bonds if amounts are available therefor pursuant to the Indenture and if the Trustee is instructed to do so by the Authority. "**Turbo Term Bond Maturity**" means the payment of principal or Accreted Value required to be made upon the Maturity Date of any Turbo Term Bond, as such schedule is set forth in a Series Supplement.

Failure by the Authority to make Turbo Redemptions will not constitute an Event of Default or a Subordinate Payment Default under the Indenture to the extent that such failure results from the insufficiency of available Collections to make such Turbo Redemptions.

Payment Priorities..... Unless an Event of Default has occurred, the Series 2006 Bonds are paid in the following order of priority (collectively, the "**Payment Priorities**"): (1) first, the Senior Bonds are Fully Paid in chronological order of Serial Maturities, Sinking Fund Installments and Maturity Dates therefor; (2) second, the First Subordinate Bonds are Fully Paid; (3) third, the Second Subordinate Bonds are Fully Paid; (4) fourth, the Third Subordinate Bonds are Fully Paid; and (5) fifth, any Additional Subordinate Bonds are Fully Paid in accordance with the provisions of the applicable Series Supplement.

Within a Payment Priority, redemptions made under the Indenture will be credited as follows: (i) the amount of any Turbo Redemptions shall be credited against both Sinking Fund Installments and Turbo Term Bond Maturities for the Turbo Term Bonds in the order of priority and within a priority in direct chronological order as provided in the applicable Series Supplement; and (ii) the amount of any Sinking Fund Installments made shall be credited against Turbo Term Bond Maturities for the Turbo Term Bonds in the order of priority and within a priority in direct chronological order as provided in the applicable Series Supplement; provided, however, that Sinking Fund Installments scheduled for the same date shall be credited on a Pro Rata basis regardless of the maturity date of the related Term Bond Maturity. See Appendix F - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - INDENTURE" attached hereto. For a description of the Payment Priorities following an Event of Default see "Events of Default" below.

A Bond shall be deemed "**Fully Paid**" only if: (i) 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 (ii) such Bond shall have matured or been called for redemption and, on such Maturity Date or redemption date, money for the payment of the principal or Accreted Value 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 (iii) such Bond is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided in the Indenture; or (iv) such Bond has been defeased as provided the Indenture (whether as part of a defeasance of all or less than all of the Bonds).

Senior Liquidity Reserve Account..... The Senior Liquidity Reserve Account will be established and maintained by the Trustee and initially funded from proceeds of the issuance of the Series 2006 Senior Bonds in an amount equal to $33,274,125.00 (the "**Senior Liquidity Reserve Requirement**"), which shall be maintained for so long as any Series 2006 Senior Bonds are Outstanding (and zero thereafter), which amount may (but is not required to) be amended upon the issuance of Senior Additional Bonds

in accordance with the applicable Series Supplement.

Amounts in the Senior Liquidity Reserve Account will be available to pay interest on and Turbo Term Bond Maturities of Series 2006 Senior Bonds but will not be available for Sinking Fund Installments or Turbo Redemptions on such Bonds. Unless an Event of Default has occurred, while any Series 2006 Senior Bonds are outstanding, Collections (to the extent available) will be used to replenish the Senior Liquidity Reserve Account to the Senior Liquidity Reserve Requirement.

Optional Redemption ..... The Series 2006A Senior Current Interest Bonds are subject to redemption at the option of the Authority (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 Turbo Term Bonds, and (2) in whole or in part on any date on or after June 1, 2014, from any Maturity Date selected by the Authority in its discretion and on such basis as the Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date.

The Series 2006B First Subordinate CABS, the Series 2006C Second Subordinate CABs, and the Series 2006D Third Subordinate CABs are subject to redemption at the option of the Authority (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 Turbo Term Bonds, and (2) in whole or in part on any date on or after June 1, 2014, from any Maturity Date selected by the Authority in its discretion and on such basis as the Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the Accreted Value on the redemption date.

Other than as provided above, the Series 2006 Bonds shall be redeemable prior to maturity in accordance with their terms and the terms of the Indenture.

If the Authority establishes a defeasance escrow for the Series 2006 Bonds, then Turbo Term Bonds shall be retired in accordance with the Optional Redemption provisions described above, and in amounts that shall be determined by reference to the Projected Turbo Redemptions (see the chart under the caption "THE SERIES 2006 BONDS - Projected Turbo Redemptions") that, as of the date of such redemption, were projected to but have not been paid with respect to such Turbo Term Bonds. Any such redemption, in whole or in part, shall be from any maturity selected by the Authority in its discretion and, within a maturity, on a Pro Rata basis. See Appendix F — "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS — INDENTURE" attached hereto.

Mandatory Clean-up Call..... The Series 2006 Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the Bond Obligation being redeemed plus interest accrued to the redemption date at any time that the available amounts on deposit in the Pledged Accounts equal or exceed the aggregate Bond Obligation of, and accrued interest on, all Outstanding Bonds.

Bond Structuring Assumptions and Amortization ..... The Series 2006 Bonds were structured on the basis of forecasts, which themselves are based on assumptions, as described herein. Among these are a forecast of U.S. cigarette consumption contained in the Global Insight Cigarette Consumption Report, and a forecast of future population in the County based on the Global Insight Population 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 Accounts and all earnings on amounts on deposit in the Accounts established under the Indenture. In addition, such forecasts were used to project amounts expected to be available for redemption of the Series 2006 Bonds from Turbo Redemptions and the resulting expected average lives of the Series 2006 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 Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Distributions and Priorities ..... "**Collections**" consist of all funds collected with respect to TSRs, amounts paid to the Authority under any Swap Contract, and investment earnings on the Pledged Accounts. All Collections received by the Trustee, excluding investment earnings on amounts on deposit in Accounts with the Trustee under the Indenture, will be promptly deposited by the Trustee into an account established and maintained by the 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 Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account, in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied as described under "Transfers to Accounts" below, in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. In addition, immediately preceding the time when the application of funds on deposit in the Collections Account is made pursuant to the Indenture, the Trustee shall deposit in the Collections Account and apply as described in the Indenture all Collections consisting of investment earnings available on such date on amounts on deposit with the Trustee under the Indenture (excluding amounts in the Costs of Issuance Account, the Rebate Account, the Operating Account, the Operating Contingency Account and the Partial Lump

Sum Payment Account), except that all amounts in the Senior Liquidity Reserve Account in excess of the Senior Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Indenture, taking into account investment earnings and other amounts available on such date, shall be transferred to the Senior Debt Service Account (except as otherwise provided under "Transfers to Accounts" below) and all investment earnings available on such date in the Capitalized Interest Subaccount shall be maintained in the Senior Debt Service 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, Total 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 under the MSA 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.

"**Swap Payment**" means any payment with respect to a Swap Contract, other than any Termination Payment with respect to a Swap Contract.

"**Termination Payment**" means any payment made by the Authority 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 ..... **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 Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts as follows:

(i) to the Operating Account, an 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 Senior 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 Senior 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 Senior Bonds and 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 or Accreted Value of the Bonds will have been paid as described in clauses (ii), (iii) and (iv) under "Distribution Date Transfers" below;

(iii) to the Senior 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, Sinking Fund Installment or Term Bond Maturity (including Turbo Term Bond Maturities) if any, due for Senior Bonds in or scheduled for the next succeeding Bond Year, plus (b) any Serial Maturities, 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 and Turbo Term Bond Maturity shall first be adjusted to account for prior principal or Accreted Value payments;

(iv) unless an Event of Default has occurred, to the Senior Liquidity Reserve Account, an amount sufficient to cause the amount on deposit therein to equal the Senior Liquidity Reserve Requirement, provided that on any Distribution Date on which the amount on deposit in the Senior Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Senior Liquidity Reserve Account, including a Termination Payment) equals or exceeds the principal or Accreted Value of and interest on all Outstanding Senior Bonds, the amount on deposit in the Senior Liquidity Reserve Account first shall be transferred to the Senior Turbo Redemption Account and applied to the Turbo Redemption of all Outstanding Senior Bonds, and second shall be transferred to the First Subordinate Turbo Redemption Account and applied to the Turbo Redemption of Outstanding First Subordinate Bonds;

(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;

(vi) to the Senior Turbo Redemption Account, all amounts remaining in the Collections Account until no Senior Bonds are Outstanding;

(vii) to the First Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no First Subordinate Bonds are Outstanding;

(viii) to the Second Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Second Subordinate Bonds are Outstanding; and

(ix) to the Third Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Third Subordinate Bonds are Outstanding.

Distribution Date Transfers..... Unless an Event of Default has occurred, on each Distribution Date the Trustee shall apply amounts in the various Accounts in the following order of priority:

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

(ii) from the Senior Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, the Serial Maturity, Sinking Fund Installment and Term Bond Maturity (including Turbo Term Bond Maturity) for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Sinking Fund Installment and Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Sinking Fund Installment or Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iii) from the Senior Liquidity Reserve Account, to pay, in the following order, the Serial Maturity and Term Bond Maturity (including Turbo Term Bond Maturity), if any, for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iv) from the Senior Turbo Redemption Account, to redeem Senior Bonds which are Turbo Term Bonds on such Distribution Date (or a special redemption date pursuant to the Indenture), provided that all Senior Bonds shall be redeemed in accordance with clause (1) of the Payment Priorities;

(v) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by Rating Confirmation with respect to the Senior Bonds which are then rated by a Rating Agency, to redeem Turbo Term

Bonds on such Distribution Date (or special redemption date pursuant to the Indenture) in accordance with Turbo Redemption provisions of the Indenture, provided that any redemptions shall redeem Bonds in accordance with the Payment Priorities;

(vi) from the First Subordinate Turbo Redemption Account, to redeem First Subordinate Bonds on such Distribution Date (or a special redemption date pursuant to the Indenture) in accordance with the Indenture;

(vii) from the Second Subordinate Turbo Redemption Account, to redeem Second Subordinate Bonds on such Distribution Date (or a special redemption date pursuant to the Indenture) in accordance with the Indenture; and

(viii) from the Third Subordinate Turbo Redemption Account, to redeem Third Subordinate Bonds on such Distribution Date (or a special redemption date pursuant to the Indenture) in accordance with the Indenture.

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

"**Operating Cap**" means (i) $200,000 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 Consumer Price Index ("**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.

"**Operating Expenses**" means the reasonable operating and administrative expenses of each of the Authority and the Borrower (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, insurance premiums, deductibles and retention payments, and costs of meetings or other required activities of the Authority or the Borrower), legal fees and expenses of the Authority and the Borrower, its respective directors, officers and employees, fees and expenses incurred for professional consultants and fiduciaries (including, but not limited to, computation of the amount of Tax Obligations and related computations), the fees, expenses, and disbursements of the Trustee, including the fees and expenses of counsel to the Trustee, Termination Payments, the costs incurred, as determined by the County, in order to preserve the tax-exempt status of any Tax-Exempt Bonds, the costs related to enforcement of the County's rights under the MOU or the ARIMOU, the costs related to the Authority's or the Borrower's or the Trustee's enforcement rights with respect to the Basic Documents, and all Operating Expenses so identified in the Indenture. The term "Operating Expenses" does not include the Costs of Issuance.

"**Authority Tax Certificate**" means the Authority Tax Certificate executed by the Authority at the time of issuance of Series 2006 Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"**Tax Obligations**" means the Rebate Requirement 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 Authority Tax Certificate.

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

Events of Default ..... The occurrence of any of the following events will constitute an "**Event of Default**" under the Indenture: (i) failure to pay when due any Swap Payment or interest on any Senior Bonds; (ii) failure to pay when due any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds; or (iii) failure of the Authority to observe or perform any other covenant, condition, agreement, or provision contained in the Senior Bonds or in the Indenture relating to the Senior Bonds, 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 Authority by the Trustee or by the Owners of a least 25% in Bond Obligation of the Senior Bonds then Outstanding. In the case of a default specified in this paragraph, if the default is such that it cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the Authority within the 60-day period and diligently pursued until the default is corrected.

A Subordinate Payment Default is **not** an Event of Default under the Indenture. "**Subordinate Payment Default**" means a failure to pay when due interest or principal or Accreted Value at maturity on any First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds or Additional Subordinate Bonds.

Extraordinary Prepayment ..... 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:

(i) until the Senior Bonds are no longer Outstanding, the Trustee shall apply all funds in the Senior Debt Service Account, the Senior Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Senior Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Senior Current Interest Bonds (including Senior Convertible Bonds after the Conversion Date) and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, second, principal or Accreted Value on all Senior Bonds then Outstanding;

(ii) until the First Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the First Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all First Subordinate Bonds then Outstanding;

(iii) until the Second Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Second Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all Second Subordinate Bonds;

(iv) until the Third Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Third Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all Third Subordinate Bonds;

(v) the application of funds with respect to Additional Subordinate Bonds shall be in accordance with the provisions of the applicable Series Supplement; and

(vi) notwithstanding anything to the contrary in the Indenture, the value of any Capital Appreciation Bonds that are Series 2006 First Subordinate Bonds, Series 2006 Second Subordinate Bonds or Series 2006 Third Subordinate Bonds shall continue to accrete at the Default Rate (including accretion on any unpaid Accreted Value), to the extent legally permissible, after the Maturity Date for such Bonds if not Fully Paid on the Maturity Date.

"**Pro Rata**" means, for an allocation of available amounts to any payment of interest, Accreted Value, 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 the Authority 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.

"**Default Rate**" means the rate of interest per annum set forth in a Series Supplement at which the First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds will accrete on and during the continuance of a Subordinate Payment Default for such Bonds.

Additional Bonds..... Additional Bonds may be issued to refund Bonds in whole or in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) or for any other purpose but only if upon the issuance of such Additional Bonds: (A) the amount on deposit in the Senior Liquidity Reserve Account will be at least equal to the Senior Liquidity Reserve Requirement; (B) no Event of Default shall have occurred and be continuing after the date of issuance of the Additional Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Additional Bonds as computed on the basis of new projections on the date of sale of the Additional Bonds will not exceed (x) the remaining weighted average life of each such Turbo Term Bond as computed by the Authority on the basis of new projections assuming that no such Additional Bonds are issued plus (y) one year;

	and (D) a Rating Confirmation is received for any Bonds that will remain Outstanding after the date of issuance of the Additional Bonds which are then rated by a Rating Agency. In determining compliance with clause (C) of this paragraph, the Authority may rely conclusively on a certificate of a financial advisory or underwriting firm, who may rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption.
Additional Subordinate Bonds.....	Additional Subordinate Bonds may be issued by the Authority without satisfying the requirements of the Indenture relating to Additional Bonds, for any lawful purpose, including to refund all or a portion of the Bonds, if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid.
Covenants	The County, the Borrower, and the Authority have made certain covenants for the benefit of the Bondholders. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – THE INDENTURE" attached hereto for a summary of the covenants made by the Authority, Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – THE SECURED LOAN AGREEMENT" attached hereto for a summary of covenants made by the Borrower, and Appendix F – "SUMMARY OF THE PRINCIPAL LEGAL DOCUMENTS – THE PURCHASE AND SALE AGREEMENT" attached hereto for a summary of the covenants made by the County.
Continuing Disclosure	Pursuant to the Indenture, the Authority has agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any State information repository (each, a "**Repository**") for purposes of Rule 15c2-12(b)(5) promulgated by the U.S. Securities and Exchange Commission pursuant to the Securities Act of 1934, as amended ("**Rule 15c2-12**"), certain annual financial information and operating data and, in a timely manner, notice of certain material events. See "CONTINUING DISCLOSURE" herein.
Ratings	The ratings for the Series 2006 Bonds address only the ability of the Authority to pay interest when due, or principal or Accreted Value of such Series 2006 Bonds on the respective Maturity Dates therefor, as set forth on the inside cover page of this Offering Circular. The ratings do not address the payment of Sinking Fund Installments or Turbo Redemptions on the Series 2006 Bonds. A rating is not a recommendation to buy, sell or hold securities, and such ratings are subject to revision or withdrawal at any time. See "RATINGS" herein.
Risk Factors	Reference is made to "RISK FACTORS" herein for a description of certain considerations relevant to an investment in the Series 2006 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 Bonds.

Tax Matters.....	In the opinion of Orrick, Herrington & Sutcliffe LLP, ("**Bond Counsel**"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2006 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (as amended, the "**Code**") and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the Series 2006 Bonds is not a specific preference item for purposes of federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006 Bonds. See "TAX MATTERS" herein.
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, the Loan Agreement, and the Continuing Disclosure Agreement may be obtained by written request from the Trustee at The Bank of New York Trust Company, N.A., 515 S. Flower Street, Los Angeles, California 90071, Attention: Corporate Trust Department. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Circular is not to be construed as a contract or agreement among the Authority, the Borrower, the County and the purchasers or Bondholders.

(THIS PAGE INTENTIONALLY LEFT BLANK)

PLAN OF REFUNDING

A portion of the proceeds of the Series 2006 Bonds will be used to refund all of the Authority's outstanding Tobacco Settlement Asset-Backed Bonds, Series 2001A and Series 2001B (collectively, the "**2001 Bonds**") issued under that certain Indenture, dated as of December 1, 2001 (the "**Prior Indenture**"), between the Authority and the Trustee, as trustee thereunder (the "**2001 Indenture Trustee**"). The refunding of the 2001 Bonds will be effected by depositing a portion of the proceeds of the Series 2006 Bonds in the escrow fund (the "**Escrow Fund**") created and established under the Refunding Escrow Agreement, dated as of May 1, 2006, between the Authority and the 2001 Indenture Trustee. The government obligations acquired with such proceeds and other monies deposited in the Escrow Fund are scheduled to mature in such amounts and at such times and bear interest at such rates as to provide amounts sufficient to pay the principal of and interest due on the 2001 Bonds through the dates fixed for their redemption or payment at maturity. See "VERIFICATION OF MATHEMATICAL COMPUTATIONS" herein.

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of the Series 2006 Bond proceeds, together with other available funds, are set forth below:

Estimated Sources of Funds:	
Sale Proceeds of Series 2006 Bonds	$563,175,366
Amounts Held Under the Prior Indenture	66,563,409
Total	$629,738,775
Estimated Uses of Funds:	
Net Proceeds to the Borrower	$123,514,513
Deposit to Escrow Fund	455,390,535
Deposit to Capitalized Interest Subaccount	12,261,237
Deposit to Senior Liquidity Reserve Account	33,274,125
Costs of Issuance [1]	5,298,365
Total	$629,738,775

[1] Includes underwriters' discount, rating agency fees, financial advisory fees, legal fees, printing costs and other costs.

RISK FACTORS

Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2006 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 Bonds and does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2006 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 Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Series 2006 Bonds or, in certain circumstances, could lead to a complete loss of a Bondholder's investment. There can be no assurance that other risk factors will not become material in the future.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various PMs, certain of the Settling States and other public entities challenging the MSA and/or the Qualifying Statutes and related legislation. One or more of the lawsuits, several of which remain pending, allege, among other things, that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable under the Commerce Clause and certain other provisions of the U.S. Constitution and the federal antitrust laws, as described below under "– *Grand River, Freedom Holdings and Related Cases*" and "– *Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection. In addition, some of the lawsuits allege that the MSA and/or related state legislation are void or unenforceable under the federal civil rights laws, state constitutions, consumer protection laws and unfair competition laws. Certain of these lawsuits seek, and, if ultimately successful, could result in, a determination that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable. Certain of the lawsuits further seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. To date, challenges to the MSA or related state legislation have not been ultimately successful, although three such challenges have survived initial appellate review of motions to dismiss. Two of these three challenges, both in a federal district court in New York (Second Circuit), have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related statutes. In these cases, certain decisions by the U.S. Court of Appeals for the Second Circuit have created heightened uncertainty as a result of that court's interpretation of federal antitrust immunity and Commerce Clause doctrines as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts, which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes do not violate the Commerce Clause of the U.S. Constitution and are protected from antitrust challenges based on established antitrust immunity doctrines. In addition, proceedings are pending or on appeal in certain other cases, including a challenge by certain NPMs in a federal court in Louisiana (Fifth Circuit), alleging, *inter alia*, that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law and equal protection of the laws guaranteed under the U.S. Constitution and the Louisiana constitution. On March 1, 2006, the U.S. Court of Appeals for the Fifth Circuit vacated the district court's dismissal of the plaintiffs' complaint and remanded the case for reconsideration. See "– *Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection. The MSA and related state legislation may also continue to be challenged in the future. A determination 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 TSRs available to the Authority to make payments with respect to the Series 2006 Bonds, including payments of Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 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 and Strategic Contribution Fund Payments payable by a PM if the PM experiences a loss of market share in the U.S. 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 by an Allocable Share Release Amendment, will continue to constitute a Qualifying Statute within the meaning of the MSA. 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 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, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the U.S. Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits 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 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 "– *Grand River, Freedom Holdings and Related Cases*" and "– *Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection.

A determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA itself; such a determination could, however, have an adverse effect on payments to be made under the MSA if one or more NPMs were to gain market share. See "– Other Potential Payment Decreases Under the Terms of the MSA – *NPM Adjustment*," "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.

Grand River, Freedom Holdings and Related Cases. Among the pending challenges to the MSA and/or related state legislation are two lawsuits referred to herein as *Grand River* and *Freedom Holdings*, both of which are pending in the U.S. District Court for the Southern District of New York. The *Grand River* case is pending against the attorneys general of 31 states, including the State, and alleges, among other things, that (a) the MSA creates an unlawful output cartel under federal antitrust law and state legislation enacted pursuant to the MSA mandates or authorizes such cartel and is thus preempted by federal law and that (b) the MSA and related statutes are invalid or unenforceable under the Commerce Clause and other provisions of the U.S. Constitution. The plaintiffs in *Grand River* seek to enjoin the enforcement of the Qualifying Statutes and Complementary Legislation by the *Grand River Defendant States* (defined below), including the State. The *Freedom Holdings* case is pending against the attorney general and the commissioner of taxation and finance of the State of New York and is based on the same purported claims as the *Grand River* case (including, as discussed below, a Commerce Clause claim asserted by the plaintiffs in their Second Supplemental and Amended Complaint following a Second Circuit ruling on the issue in the *Grand River* case). The plaintiffs in *Freedom Holdings* seek to enjoin the enforcement of New York's Qualifying Statute and Complementary Legislation. These suits have survived appellate review of motions to dismiss for failure to state a claim upon which relief can be granted and 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 its decision as to the pending claims. To date, *Grand River* and *Freedom Holdings*, along with *Xcaliber v. Ieyoub* (discussed below), are the only cases challenging the MSA or related legislation that have survived initial appellate review of motions to dismiss. Moreover, *Grand River* and *Freedom Holdings* are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related state legislation.

On July 1, 2002, *Grand River Enterprises Six Nations Ltd. v. Pryor* was filed in the U.S. 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 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 below), however, the District Court granted the plaintiffs' motion in *Grand River* to reinstate, against the New York Attorney General only, that portion of the complaint alleging that New York's Qualifying Statute and New York's Complementary Legislation conflict with antitrust laws and are preempted by federal law.

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

plaintiffs filed a petition with the Second Circuit for rehearing on the Indian Commerce Clause ruling. On January 3, 2006, the Second Circuit denied all parties' petitions for rehearing.

In its decision, the Second Circuit found that extensive negotiations by the Settling State defendants over the MSA and the related statutes that took place in New York, and the MSA's ultimate execution in New York, constituted transacting business under New York Law and that therefore the initial requirement for a finding of personal jurisdiction 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 New York 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 in *Grand River* noted that because it was reviewing a motion to dismiss, it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit held that although each state's Qualifying Statute and Complementary Legislation apply to cigarette sales within such state, the plaintiffs sufficiently stated a possible claim that these statutes together create a national or "interstate" regulatory policy and thereby exert "extraterritorial control" over out-of-state transactions in contravention of the Commerce Clause. The Second Circuit acknowledged that in *Freedom Holdings* (discussed below) it had ruled that plaintiffs failed to state a claim that the State's Complementary Legislation had violated the Commerce Clause, but explained that it did so because plaintiffs there had not sufficiently alleged an extraterritorial effect of that legislation. To date, *Grand River*, and, as a technical matter, *Freedom Holdings* (pursuant to the grant of a motion to amend the complaint in that matter to include a Commerce Clause claim), are the only cases in which a Commerce Clause challenge to the MSA and related statutes has not been the subject of a summary judgment dismissal. However, other such challenges are currently pending in various jurisdictions. An adverse ruling on Commerce Clause grounds could potentially lead to invalidation of the MSA and the Qualifying Statutes in their entirety and result in the complete loss of a Bondholder's outstanding investment.

With regard to the reinstatement of the non-New York defendants, including the State, the Second Circuit explained that where an out of state defendant has "transacted business" in the State of New York and there is "substantial nexus" between that transaction and the litigation in question, the federal courts in the state can obtain jurisdiction over the defendants. The Second Circuit concluded that by negotiating the MSA in New York, the attorneys general "transacted business" for the purpose of conferring jurisdiction in federal courts in New York. The Court also held that there was "substantial nexus" between the MSA negotiations and the lawsuit, because although the challenged statutes are discrete acts of each state, they were integral to the operation of the MSA and were negotiated as such. As a defendant in the action, the Attorney General of the State would, in the absence of other proceedings, be bound by a decision in this case, and could, for example, be enjoined from enforcing the State's Qualifying Statute and Complementary Legislation and possibly the MSA.

On April 18, 2006 the non-New York defendants, including the California Attorney General, filed a petition for certiorari review with the U.S. Supreme Court challenging the Second's Circuit ruling on the issue of personal jurisdiction. The grant of this certiorari petition is within the discretion of the U.S. Supreme Court.

Grand River remains pending in the Southern District and the parties have engaged in discovery with respect to the antitrust and Commerce Clause claims. A ruling in the *Grand River* case invalidating the Qualifying Statute and Complementary Legislation would conflict with rulings by district courts in the Ninth Circuit that have upheld California's Qualifying Statute and Complementary Legislation. Such a conflict may result in significant uncertainty regarding the validity and enforceability of the MSA and/or related legislation in California and elsewhere and could result in the complete loss of a Bondholder's investment. See "Possibility of Conflict Among Federal Courts" below. 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 not be subject to appeal as of right to the U.S. Supreme Court. No assurance can be given (1) that the Supreme Court would choose to determine the jurisdictional issue or hear and determine any appeal

relating to the validity or enforceability of MSA or related legislation in this or any other case, or (2) as to the outcome of the certiorari or any appeal, even if heard by the Supreme Court. A Supreme Court decision to affirm or to decline to review a Second Circuit ruling that is adverse to the defendants in *Grand River* or other similar case, challenging validity or enforceability of MSA or related legislation, could result in the complete cessation of the TSRs available to make payments on the Series 2006 Bonds. Moreover, even if ultimately reversed by the Supreme Court, a Second Circuit decision adverse to the defendants in *Grand River* could, unless stayed pending appeal at the discretion of the court, result in the complete cessation of the TSRs available to make payments on the Series 2006 Bonds during the pendency of the appeal.

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

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

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

In April 2004, the plaintiffs in *Freedom Holdings* filed an amended complaint, which was supplemented in November 2004 and included requests for (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and are thus preempted by federal antitrust law and

(2) an injunctive relief enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint did not seek an injunction enjoining the enforcement or administration of the MSA, was limited only to claims under the federal antitrust laws, and did not allege that the MSA, the New York State's Qualifying Statutes or Complementary Legislation violate the Commerce Clause or the Equal Protection Clause of the U.S. Constitution.

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

On February 6, 2006, the Southern District granted plaintiffs' renewed motion for leave to assert a claim under the Commerce Clause. On February 10, 2006, plaintiffs filed a Second Supplemental and Amended Complaint. The plaintiffs now seek (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and is preempted thereby, (2) a declaratory judgment that the New York Qualifying Statute and Complementary Legislation, together with the Qualifying Statutes and Complementary Legislation of other states, regulates interstate commerce in violation of the Commerce Clause of the U.S. Constitution, and (3) an injunction permanently enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint does not seek to enjoin the enforcement or administration of the MSA. *Freedom Holdings* remains pending in the Southern District.

Possibility of Conflict Among Federal Courts. The decisions by the U.S. Court of Appeals for the Second Circuit in *Freedom Holdings* have created heightened uncertainty as a result of the court's interpretation of federal antitrust law immunity doctrines, as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts that have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes are protected from an antitrust challenge based on the *Parker* or *NP* doctrines.

An adverse decision by the Second Circuit in *Grand River* regarding the enforceability of the MSA and/or related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution could be controlling law not only within the Second Circuit but also in each of the Grand River Defendant States, including the State, unless the Second Circuit ruling with regard to the Southern District's jurisdiction over the non-New York defendants is reviewed and reversed by the U.S. Supreme Court. Such review by the U.S. Supreme Court is not available as of right. No assurance can be given that the U.S. Supreme Court would choose to undertake such a review.

In addition, an adverse decision by the Second Circuit in *Freedom Holdings* regarding the enforceability of the MSA, related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution would be controlling law only within the Second Circuit from which no appeal as of right to the U.S. Supreme Court would exist. If, however, the Second Circuit were to make a final determination in *Freedom Holdings* that (a) the MSA constitutes a *per se* federal antitrust violation, not immunized by the *NP* or *Parker* doctrines, or that New York's Qualifying Statute and Complementary Legislation authorize or mandate such a *per se* violation, or (b) New York's Qualifying Statute and New York's Complementary Legislation operates with the Qualifying Statutes and Complementary Legislation of other states to regulate interstate commerce in violation of the Commerce Clause of the U.S. Constitution, such determination could be considered to be in conflict with decisions rendered by other federal courts, including federal courts in California, which have come to different conclusions on these issues. The existence of a conflict as to the rulings of different federal courts on these issues, especially between Circuit Courts of Appeals, is one factor that the U.S. Supreme Court may take into account when deciding whether to exercise its discretion in agreeing to hear an appeal. No assurance can be given that the U.S. Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Freedom Holdings*. Any decision by the U.S. Supreme Court on the substantive merits of *Freedom Holdings* would be binding everywhere in the U.S., including in California.

Ninth Circuit Cases. On March 28, 2005, the U.S. District Court for the Northern District of California in the California case, *Sanders v. Lockyer*, dismissed an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State of California and the OPMs. The District Court, expressly unpersuaded by *Freedom Holdings*, found the MSA to be the sovereign act of the State and further found California's Qualifying Statute and Complementary Legislation to be direct legislative activity entitled to *Parker* immunity without the need for any additional *MidCal* analysis. The District Court also found the MSA and California's Qualifying Statute and Complementary Legislation to be entitled to *NP* immunity. The plaintiffs have appealed the dismissal to the Ninth Circuit Court of Appeals. The parties have filed their appellate briefs.

On August 13, 1999, in *PTI, Inc v. Philip Morris Inc.*, certain cigarette importers and cigarette distributors filed an action in the U.S. District Court for the Central District of California against the PMs and all of the state officials involved in the negotiation of the MSA and those charged with the enforcement of the Qualifying Statute and Complementary Legislation as enacted by the respective states (collectively, the "**State Defendants**"). The plaintiffs therein sought to enjoin the passage or enforcement, as the case may be, of the Qualifying Statute and Complementary Legislation. The complaint alleged, among other things, that the passage, implementation and/or enforcement of the Qualifying Statute would be preempted by federal antitrust laws and violate certain provisions of the federal constitution, including the Interstate Compact Clause, the prohibition on Bills of Attainder, the Commerce Clause, the Import-Export Clause, the Supremacy Clause, the First Amendment, the Equal Protection Clause, and the Due Process Clause. On May 25, 2000, the District Court found that jurisdiction did not exist over the non-California State Defendants, and dismissed with prejudice all federal antitrust and constitutional claims against the PMs and the State Defendants based on the merits. Like the *Sanders* Court, the *PTI* Court found antitrust immunity under both the *NP* and *Parker* doctrines. With respect to the Commerce Clause challenge, the District Court found that neither the Qualifying Statute nor the Complementary Legislation was discriminatory on its face and applied equally to in-state, out-of-state and foreign manufacturers. In addition, the Court found that the alleged burden imposed on interstate commerce by the Qualifying Statute did not clearly exceed the putative local benefits of discouraging cigarette consumption.

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 (see the previous discussion of *Sanders v. Lockyer*), Louisiana, Oklahoma, Kansas, Kentucky, Tennessee and Arkansas. The issues raised in *Freedom Holdings* or *Grand River* are also raised in many of these other cases, as briefly described below, by way of example only, and not as an exclusive or complete list.

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. In March 2006, the Fifth Circuit Court of Appeals vacated the District Court's earlier dismissal of the action and remanded the case for further proceedings to review the plaintiffs' allegations that the Louisiana Allocable Share Release Amendment violates the rights of free speech, due process of law and equal protection of the laws guaranteed under the U.S. Constitution and the Louisiana Constitution. In *A.B. Coker v. Foti*, filed in August 2005, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana, seeking, among other relief, (i) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid under the Commerce Clause and Interstate Compact Clause of the U.S. 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 U.S. Court of Appeals for the Tenth Circuit. On August 31, 2005, the District Court denied the motion to reconsider. On October 28, 2005, the Tenth Circuit referred the case for mediation conferencing. Mediation conferencing was subsequently terminated and appellate briefing was completed in February 2006.

In the Kentucky case, *Trident 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. Briefing is in progress.

Similarly, in the Tennessee case, *S&M Brands, Inc. v. Summers*, the plaintiffs seek a declaratory judgment that Tennessee Qualifying Statute (including the Allocable Share Release Amendment) and Complementary Legislation also conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On June 1, 2005, the Sixth Circuit affirmed the District Court's denial of plaintiffs' motion for a preliminary injunction with respect to the enforcement of Tennessee's Allocable Share Release Amendment. On October 6, 2005, the District Court granted Tennessee's motion to dismiss the complaint except that portion of the complaint that alleges that the state's retroactive enforcement of the state's Allocable Share Release Provision violates plaintiff's constitutional rights, which issue was not raised by the state in its motion and was therefor not addressed by the court. In its opinion, the District Court expressly rejected the Second Circuit's reasoning in sustaining antitrust challenges in the *Freedom Holdings* case and the Third Circuit's rationale for denying state action immunity in the *Bedell* and *Mariana* cases. Instead, *S&M Brands* followed the *Sanders* and *PTI* line of cases and held that Qualifying Statute and Complementary Legislation are direct state action, entitled to *Parker* immunity without the need for *MidCal* analysis. 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.

On December 12, 2005, the District Court entered a final judgment dismissing the claims seeking a declaration that the Tennessee Qualifying Statute violated Federal antitrust laws and certain provisions of the U.S. Constitution. On January 3, 2006, plaintiffs filed a notice of appeal of that judgment.

Similar cases are pending in Arkansas. In three cases pending in the U.S. District Court for the Western District of Arkansas (*Grand River Enterprises Six Nations Ltd. v. Beebe*, *International Tobacco Partners Ltd. v. Beebe*, and *Dos Santos v. Beebe*), the plaintiffs seek to enjoin preliminarily and permanently Arkansas' enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws and certain provisions of the U.S. Constitution and the Arkansas Constitution. In *International Tobacco Partners Ltd.*, the plaintiffs also seek a declaratory judgment that the MSA and Arkansas' Qualifying Statute and Complementary Legislation are preempted by federal antitrust laws and certain provisions of the U.S. Constitution. The District Court preliminarily enjoined, as against the plaintiffs only, the enforcement of Arkansas' Allocable Share Release Amendment. On August 8, 2005, the court ordered Arkansas to reimburse certain amounts it withheld pursuant to the Allocable Share Release Amendment to International Tobacco Partners Ltd. On March 6, 2006, the District Court issued orders in all three cases (1) denying Arkansas' motion to dismiss the complaint with respect to the plaintiffs' claim that the retroactive application of the Allocable Share Release Amendment violates the plaintiffs' right to due process of law under the Fourteenth Amendment of the U.S. Constitution and (2) granting Arkansas' motion to dismiss the complaint in all other respects. On March 14, 2006, the District Court in *Grand River v. Beebe* denied the plaintiffs' motion to preliminarily enjoin the Allocable Share Release Amendment.

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. On February 7, 2006, the District Court granted the state's motion for summary judgment and dismissed the case on its merits and denied the plaintiffs' motion to supplement the record with additional facts. On February 16, 2006, the plaintiffs appealed to the Court of Appeals for the Tenth Circuit. 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. On January 30, 2006, the plaintiffs amended the complaint, which now seeks to enjoin the enforcement of Kansas' Complementary Legislation and Kansas' Qualifying Statute in its entirety. Although the complaint asserts that the MSA is also preempted by federal antitrust laws and certain provisions of the U.S. Constitution, it does not specifically seek to enjoin the enforcement thereof. Both parties filed motions for summary judgment, which were dismissed by the court. Kansas has filed a motion to dismiss. On April 24, 2006, plaintiffs filed a new motion for summary judgment.

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 a final adverse ruling in one or more of the cases discussed above, it could have a material adverse effect on the amount of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds and could result in the complete loss of a Bondholder's investment. For a description of the opinions of Bond 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 December 31, 2005, there were 12 cases on appeal in which verdicts were returned against Philip Morris, including (i) a $74 billion punitive damages judgment against Philip Morris in the *Engle* class action, which has been overturned by a Florida district court of appeal and is currently on appeal to the Florida Supreme Court; and (ii) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. On December 15, 2005, however, the Illinois Supreme Court reversed the judgment against Philip Morris in *Price* and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. In January 2006, the plaintiffs filed a motion asking the court to reconsider its decision in *Price*. On May 5, 2006, the Supreme Court of Illinois denied this motion. It is possible that the plaintiffs will seek further appeals. No assurance can be given that that such appeals will not be granted or that they will not be decided in the plaintiffs' favor. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY - Civil Litigation" herein.

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) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (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 that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or mediation of 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 Cigarette Consumption Report. In addition, the financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA, and have a material adverse effect on the amount of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds. For a detailed discussion of tobacco industry litigation and related matters, see "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY – Civil Litigation" and "LEGAL CONSIDERATIONS" herein.

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

Smoking Trends. As discussed in the Global Insight Cigarette Consumption Report, cigarette consumption in the U.S. has declined since its peak in 1981 of 640 billion cigarettes to an estimated 381 billion cigarettes in 2005. 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 Cigarette Consumption Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.81% to 182 billion cigarettes in 2046 under the Global Insight Base Case Forecast (as defined herein), which represents a decline in per capita consumption at an average rate of 2.53% 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.

On March 8, 2006, the National Association of Attorneys General and the American Legacy Foundation jointly announced that cigarette consumption in 2005 had fallen to 378 billion cigarettes. The Global Insight 2005 estimate of 381 billion cigarettes is slightly higher. For a more detailed discussion of the Global Insight methodology, see "– GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein and APPENDIX A "– GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached hereto.

According to the Global Insight Cigarette 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. The FDA has approved Varenicline, a Pfizer product to be marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. Three 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 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. On March 9, 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. The company expects to move to Phase III trials in the second half of 2007. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. Global Insight expects that products such as these will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. One SPM has also introduced a cigarette with reportedly little or no nicotine. Future FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels. Such new products or similar products, if successful, or such FDA regulation, if enacted, could have a material adverse effect on cigarette consumption.

A decline in the overall consumption of cigarettes beyond the levels forecasted in the Global Insight Cigarette Consumption Report could have a material adverse effect on the payments by PMs under the MSA and the amounts of TSRs available to the Authority to make payments on the Series 2006 Bonds.

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charge state employees who smoke higher health insurance premiums than non-smoking state employees. For example, on January 26, 2006, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant. Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to state employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc. and Northwest Airlines, are now charging smokers higher premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the 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 U.S. The federal excise tax per pack of 20 cigarettes is $0.39 as of February 2006. 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 and $2.00 per pack in Cook County, Illinois, which includes Chicago. According to the Global Insight Cigarette Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. As a result, the current population weighted average state excise tax is $0.913 per pack. In 2006 at least ten states are considering proposed excise tax increases, including increases of $1.00 in New York and up to $2.60 in California. The proposed $2.60 per pack tax increase on cigarettes in California is an initiative on the State's November 2006 ballot. If the proposed $2.60 increase becomes effective, California would have the nation's highest cigarette tax. In addition, both houses of the Texas legislature have approved bills that would raise the state excise tax by $1.00 over a three-year period beginning in January 2007. The governor is expected to sign the reconciled version of the legislation.

As mentioned above, at least one state, Minnesota, currently imposes a 75 cents "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld in Minnesota (a Previously-Settled State) state court as not in violation of Minnesota's settlement with the tobacco companies.

According to the Global Insight Cigarette 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 sixteen states and a few large cities. California imposed comprehensive statewide smoking bans in 1998 and banned smoking in its prisons effective July 1, 2005. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Delaware banned smoking in all indoor public areas in 2002. 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, 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 December 2005 Chicago passed a smoking ban that 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. In January 2006, New Jersey adopted a comprehensive ban which went 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 January 2006, the District of Columbia enacted an extensive ban which will be fully in effect in January 2007. In 2006, Arkansas, Colorado, Hawaii, Utah, and Puerto Rico enacted similar legislation. It is expected that the restrictions will continue to proliferate. Currently, at least one state, Ohio, is considering a comprehensive ban. On January 26, 2006, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant. In addition, the American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 17, 2006, there were 2,216 municipalities in the U.S. with indoor smoking restrictions. The first extensive outdoor smoking restrictions were instituted on March 17, 2006 in Calabasas, California.

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 or municipal 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 Cigarette Consumption Report and thereby could have a material adverse effect on the amounts of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds. See "CERTAIN INFORMATION RELATING TO THE 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 amount of TSRs available to the Authority below the respective amounts required to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds. Both the Settling States and one or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2005. No assurance can be given as to the magnitude of the adjustments that may result upon resolution of those disputes. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments. For additional information regarding the MSA and the payment adjustments, see "– NPM Adjustment" in this subsection and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

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

Growth of NPM Market Share and Other Factors. The assumptions used to project Collections and structure the Series 2006 Bonds contemplate declining consumption of cigarettes in the U.S. 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 and Strategic Contribution Fund Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. One SPM has introduced a cigarette with reportedly no nicotine. If consumers used 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, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation.

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM would have been required to make had it been a PM. At least 44 Settling States, including the State, have enacted, and other states are considering, legislation that amends this provision in their Model/Qualifying Statutes, by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM (so called "**Allocable Share Release Legislation**"). The National Association of Attorneys General ("**NAAG**") has endorsed these legislative efforts. A majority of the PMs, including all OPMs, have indicated their agreement in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Release Legislation, such Settling State's previously enacted Model Statute or Qualifying Statute will continue to constitute a Model Statute or Qualifying Statute within the meaning of the MSA. Following a challenge by NPMs, the U.S. District Court for the Southern District of New York in September 2004 enjoined New York from enforcing its Allocable Share Release Legislation. NPMs are also currently challenging Allocable Share Release Legislation in the State and in Arkansas, Kansas, Kentucky, Louisiana, Oklahoma and Tennessee. It is possible that NPMs will challenge such legislation in other states. See "–Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. To the extent that either (i) other states do not enact or enforce Allocable Share Release Legislation or (ii) 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 amount of TSRs available to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" and "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" herein.

NPM Adjustment.

Description of the NPM Adjustment. The NPM Adjustment, measured by domestic sales of cigarettes by NPMs, operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions

---

* The aggregate market share of NPMs utilized in the Cash Flow Assumptions may differ materially from the market share information utilized by the MSA Auditor when calculating the NPM adjustments.

must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a Market Share Loss (as defined in the MSA) for the applicable year must exist, which means that the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997 (a condition that has existed for every year since 2000), (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, and (3) the Settling States in question must be proven to not have diligently enforced their Qualifying Statutes.* The Settling States and the PMs selected The Brattle Group in May 2004 as the current economic consultants responsible for making the significant factor determinations.

Application of the NPM Adjustment. The entire NPM Adjustment is ultimately applied to a subsequent year's Annual Payment and Strategic Contribution Fund Payment due to those Settling States (i) that have been proven to have not diligently enforced their Qualifying Statutes throughout the year or (ii) that have enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the PMs' market share loss is greater than 16⅔%, then the NPM Adjustment will equal 50% plus an amount determined by formula as set forth in the footnote below.†

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments and Strategic Contribution Fund Payments due from the PMs and then ultimately allocated on a Pro Rata (as defined in the MSA) basis only among those Settling States (i) that have been proven to have not diligently enforced their Qualifying Statute or (ii) that have enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction.‡ However, the practical effect of a decision by a PM to claim an NPM Adjustment for a given year and pay its portion of the amount of such claimed NPM Adjustment into the Disputed Payments Account, or withhold payment of such amount, would be to reduce the payments to all Settling States on a Pro Rata basis until, for any particular Settling State, a resolution is reached regarding the diligent enforcement dispute for such state.

Settlement of Calendar 1999 through 2002 NPM Adjustment Claims. In June 2003, the OPMs and the Settling States settled all NPM Adjustment claims for the years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of an OPM's right to an NPM Adjustment for the years 2001 and 2002. In connection therewith, the OPMs and the Settling States agreed prospectively that OPMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment with respect thereto unless and until the selected economic consultants determine that the

---

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

† If the aggregate market share loss from the Base Aggregate Participating Manufacturer Share is greater than 16⅔%, the NPM Adjustment will be calculated as follows:

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

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

disadvantages of the MSA were a significant factor contributing to the market share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more OPMs have claimed an NPM Adjustment, such OPMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments" herein.

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

Effect of Calendar 2003 NPM Adjustment Claim on 2006 Annual Payments. Each of the three OPMs has notified the Settling States that, in connection with the market share loss for calendar year 2003, it will seek an NPM Adjustment. It has been reported in the press that both Philip Morris and Reynolds American believe that the size of the NPM Adjustment attributable to 2003 is approximately $1.2 billion (representing a $1.14 billion NPM Adjustment of approximately 17.85% of the 2004 Annual Payment, with interest).

Significant Factor Determination for Calendar Year 2003. On or about March 2, 2006, The Brattle Group made a proposed determination that the disadvantages experienced as a result of the MSA were a significant factor contributing to the related market share loss for calendar 2003. It has been reported that the MSA Auditor determined that the Market Share Loss in 2003 was 5.95%, reflecting the difference between the PMs' 99.58% 1997 market share and their 91.63% 2003 market share less 2%. Of the total 7.95% differential, it has also been reported that The Brattle Group determined that 3% to 3.5% was attributable to the MSA and then compared 3% to 3.5% to 7.95% in making its proposed significant factor determination.

By letter dated March 6, 2006, the State of New York issued to all the PMs a Notice of Intent to Initiate Enforcement Proceedings under the MSA. In that Notice of Intent the State of New York noted The Brattle Group's proposed determination and stated that the State of New York intended to initiate court proceedings against some or all PMs for a Declaratory Order construing certain terms, including "Market Share Loss," of the MSA and the question presented to The Brattle Group in the "significant factor" proceedings. On that same date, the State of New York filed a motion in the Supreme Court of the State of New York for the County of New York in *The State of New York v. Philip Morris, Inc.*, requesting a declaratory order construing the terms of the MSA. New York State asserted that The Brattle Group's initial determination was incorrectly made because it applied its "significant factor" analysis to the OPMs total loss of market share from 1997 through 2003 of 7.95%, rather than to the "Market Share Loss" as defined in the MSA, which New York State asserted is the total market share loss of the OPMS from 1997 through 2003 that is in excess of 2%, which would result in a Market Share Loss of 5.95%. On March 13, 2006, the court held that it had continuing jurisdiction over the MSA and directed that The Brattle Group, in making its "significant factor" determination, consider the MSA's impact on the OPMs' market share loss after deducting 2% from any MSA-related loss it found. The PMs' time to make a motion or rehear or reargue this order or to seek appellate relief has not expired.

On March 27, 2006, The Brattle Group made its final determination that the disadvantages experienced as a result of the MSA were a significant factor contributing to the Market Share Loss for calendar year 2003. In a statement dated March 28, 2006, the Attorneys General of Iowa and Idaho, the co-chairs of the NAAG Tobacco Committee, stated, among other things, that the Settling States believe it would not be appropriate for a PM to withhold any portion of the April 2006 Annual Payment. According to the statement, the Settling States believe that the PMs must still prove to a court that the Settling States have not diligently

enforced their Model Statutes and also believe that every Settling State will be found to have diligently enforced its Model Statute in 2003. It has been reported, however, that the general counsel of Reynolds Tobacco has stated that he believes that not all states were diligently enforcing their Model Statutes.

It has been reported that on March 31, 2006, Philip Morris made its full $3.4 billion payment, even though it believes that sum should eventually be reduced to reflect its market share loss due to its participation in the MSA, and it intends to continue to negotiate with the Settling States' Attorneys General for a reduction of its payment. It has been further reported that Lorillard paid approximately $558 million of its 2006 Annual Payment on March 31, 2006. Lorillard deposited the balance of the 2006 Annual Payment, $108 million, into the Disputed Payments Account pending final non-appealable resolution of the diligent enforcement issue with respect to 2003. Additionally, it has been reported that Reynolds American paid approximately $2.016 billion of its Annual Payment obligation for 2006, of which $647 million was deposited in the Disputed Payment Account pending resolution of the diligent enforcement issue in 2003. According to the co-chairs of the NAAG Tobacco Committee, in a statement released on April 18, 2006, the Annual Payments paid by Lorillard and Reynolds American to the Settling States constitute about 82% of the amount that was due. The three SPMs from whom the largest payments were due made substantial payments. However, one of the three paid a portion of its payment to the Disputed Payments Account, and the other two each withheld a portion of the payment due from them. It has been reported in the press that a majority of the Settling States have given notice to the PMs of each such Settling State's intent to commence enforcement proceedings under the MSA compelling the PMs to make the 2006 Annual Payment without diminution for any NPM Adjustment so long as there has not yet been a final non-appealable resolution of the diligent enforcement issue for such Settling State for the year in question.

In their April 18, 2006 statement, the co-chairs of the NAAG Tobacco Committee restated that the Settling States believe that no NPM Adjustment would be found to apply and, thus, the Settling States are entitled to receive the full payment due under the MSA. They stated that each Settling State has enacted a Model Statute, that the states all believe they have diligently enforced their Model Statute, and that they will ultimately receive the money in dispute. The statement further stated that the issues of diligent enforcement are not subject to arbitration and will be litigated in the courts of each state. Many of the Settling States are expected to initiate prompt legal action in their state courts to ensure full payment. It has been reported that several states (Reynolds American reports 26 states between April 13 and May 2), including the State, and the States of Connecticut, Illinois, Kentucky, Maine, Massachusetts, New Hampshire, New Jersey, North Carolina, Ohio, Tennessee, and Washington, have each instituted legal proceedings in their respective state courts against the PMs. They each claim that they diligently enforced their Qualifying Statute and request that the respective court enter a declaratory order finding that the 2006 Annual Payment is not subject to a 2003 NPM Adjustment, and that the PMs are not entitled to withhold or pay into the Disputed Payments Account any portion of the 2006 Annual Payment. They also assert that, in June 2003, the OPMs unconditionally released the Settling States from all claims that they may have with respect to cigarettes sold or shipped from 1999 through 2002. As previously noted, the OPMs and the Settling States entered into agreements that resolved a variety of disputes relating to cigarette sales and MSA payments from 1999 through 2002. The Settling States maintain that, since an NPM Adjustment for 2003 would be based upon cigarettes sold or shipped in 2002, the release in the June 2003 agreements bars the OPMs from claiming an NPM Adjustment for 2003.

Resolution of Diligent Enforcement Disputes. As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a Settling State has diligently enforced its Qualifying Statute or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. 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 will be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. The Connecticut court's decision has been appealed by the State of Connecticut. The Connecticut court's determination is contrary to the determination by a New York State trial 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 New York Court's decision was reversed on April 6, 2006, by the Appellate Division, First Department, of the Supreme Court of New York (the "**Appellate Division**"). The Appellate Division ruled that the MSA Auditor's decision not to apply the NPM Adjustment, and the dispute over whether that adjustment should have been applied, is "a proper subject for arbitration pursuant to the plain terms of the MSA." The Appellate Division then ordered that the motion to compel arbitration be granted. It has been reported that the defendants in the New York case are considering an appeal of the Appellate Division's decision. The Attorneys General of the Settling States, including the State, believe that the court in each Settling State that retains continuing jurisdiction over the MSA should make the determination as to diligent enforcement of such state's Qualifying Statute. Regardless of the forum in which a diligent enforcement dispute is heard, no assurance can be given as to how long it will take to resolve any such dispute with finality.

Effect of Complementary Legislation. At least 44 of the 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 an NPM and that it is in full compliance with the State's Qualifying Statute. The Attorney General is required to maintain a directory listing of all tobacco product manufacturers that have filed current and accurate certifications. No person may sell, offer or possess for sale cigarettes of a tobacco product manufacturer not included in the then current directory. Any cigarettes that have been sold, offered for sale or possessed in the State in violation of the State's Complementary Legislation will be deemed contraband and are subject to forfeiture.

All of the OPMs and other PMs have provided written assurances that the Settling States have no duty to enact Complementary Legislation, that the failure to enact such a legislation will not be used in determining whether a state has diligently enforced its Qualifying Statute pursuant to the terms of the MSA, and that the diligent enforcement obligations under the MSA shall not apply to the Complementary Legislation. In addition, the written assurances contain an agreement that the Complementary Legislation will not constitute an amendment to a Settling State's Qualifying Statute. However, a determination that a state's Complementary Legislation is invalid may make enforcement of its Qualifying Statute more difficult, which could lead to an increase in the market share of NPMs, resulting in a reduction of Annual Payments and Strategic Contribution Fund Payments under the MSA. The New York Qualifying Statute and Complementary Legislation, along with similar legislation in thirty other states, including the State, have been challenged in New York 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. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — MSA Provisions Related to Model/Qualifying Statutes" herein and Appendix F — "SUMMARY OF THE PRINCIPAL LEGAL DOCUMENTS - THE INDENTURE" attached hereto.

Conclusion. Future NPM Adjustment claims remain possible for calendar years 2004, 2005 and all future years. It has been reported that Philip Morris, Reynolds American and Lorillard will file a NPM Adjustment claim for the year 2004. The Brattle Group has not made any preliminary or final "significant factor" determinations for any year other than 2003. In addition, the "diligent enforcement" exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual Payment, and could be disputed by a PM even after the final resolution of a diligent enforcement dispute related to a prior year. If the other preconditions to an NPM Adjustment exist for a given year, disputes regarding diligent enforcement for such year may be expected if the market share of the NPMs results in an NPM Adjustment that, absent the protection of the Qualifying Statutes, would apply.

Future NPM Adjustments could be as large or larger than the reported potential $1.2 billion calendar 2003 NPM Adjustment. Although a Settling State that diligently enforces its Qualifying Statute is exempt from the NPM Adjustment, many procedural uncertainties, as described above, still remain regarding the resolution of a dispute regarding diligent enforcement. In addition, the resolution of the substance of such a dispute could take years. A decision by the PMs to pay the amount of a claimed NPM Adjustment into the Disputed Payments Account or to withhold payment of such an amount pending the resolution of the dispute would have a material adverse effect on the amounts of TSRs available to the Authority to make Turbo Redemptions and other payments on the Series 2006 Bonds during such period. Should a PM be determined with finality to be entitled to an NPM Adjustment in a future year due to non-diligent enforcement of the Qualifying Statute by the State, the operation of the NPM Adjustment would also have a material adverse effect on the amounts of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 Bonds. See "Disputed or Recalculated Payments" below. The structuring assumptions for the Series 2006 Bonds do not include any NPM Adjustments. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."

Disputed or Recalculated Payments and Disputes under the Terms of the MSA. Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "NPM Adjustment", have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. By way of example, on August 30, 2004, one of the SPMs announced that it had notified the attorneys generals 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 agreement with General Tobacco and enjoin the Settling States and NAAG from listing General Tobacco as a PM on their websites. On August 18, 2005, 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 has been reported that on January 31, 2006 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 or Strategic Contribution Fund Payments. The diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts or the application of offsets against future payments could all have a material adverse effect on the payments by the PMs under the MSA and amounts of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value on the Series 2006 Bonds. The structuring assumptions for the Series 2006 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.

On June 3, 2005, the State 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, alleging that the State 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) the State'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. On March 15, 2006, the Superior Court adopted the November 1, 2005 tentative ruling as its final order.

Bekenton is involved in similar disputes in Kentucky and Iowa. In the Kentucky case, Bekenton failed to make its full MSA payment of approximately $7.7 million in April 2005, and, instead, paid only $198,000, less than 3% of the total payment due. The State of Kentucky commenced an action against Bekenton in which Bekenton claimed that under the Relief Clause it was entitled to reduce its payment as a consequence of Kentucky's agreement with General Tobacco, which was similar to the agreement described above between the State of California and General Tobacco. On April 14, 2006, the court dismissed Bekenton's claim for a reduction, holding that the Relief Clause was not applicable since the General Tobacco agreement did not relieve General Tobacco of any payment obligations.

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

In 2005, Bekenton 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 to quit smoking "cigarettes" that are "cigarettes" for the purposes of the MSA could reduce the size of the market and cause a reduction in Annual Payments and Strategic Contribution Fund Payments. 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.

Potential Payment Adjustments for Population Changes Under the MOU and the ARIMOU

The MOU provides that the amounts of TSRs payable are subject to adjustments for population changes. The amount of the TSRs distributed to Participating Jurisdictions, including the County, pursuant to the MOU and the ARIMOU is allocated on a per capita basis, calculated using the then most current official U.S. Decennial Census figures, which are currently updated every ten years. Based on the 2000 Census, 8.31% of the residents of the State resided in the County. Pursuant to the MOU and the ARIMOU, the County is therefore entitled to an equivalent percentage of the TSRs allocable to the Participating Jurisdictions (after payments to cities that are Participating Jurisdictions). There can be no assurance that future U.S. Census will not conclude that the County represents a smaller relative percentage of the overall population of the State than in 2000, or that the TSRs payable to the County will not decline. Subsequent adjustments are expected to occur at subsequent ten-year intervals following each Census, and there can be no assurance that the percentage of

TSRs payable to the County will not materially decline following such adjustments. In addition, there can be no assurance that the frequency of such Census reports will not change, or that the methodology utilized by the U.S. in performing the Census will not change, or that any such change in methodology would not result in a determination that the County represents a smaller relative percentage of the overall State population than reported in any prior Census.

The Global Insight Population Report projects that the County's share of total State population was 8.31% in 2000, and will be 7.97% in 2010, 8.09% in 2020, 8.23% in 2030, and 8.42% in 2040 (the "**Global Insight Base Case Population Forecast**"). The forecast depends on projections with respect to domestic migration to and from the County among other factors. Global Insight states that County population inevitably will vary from the projections and forecasts in the Global Insight Population Report, and that the variations may be material and adverse. See "GLOBAL INSIGHT POPULATION REPORT" herein.

Other Risks Relating to the MSA and Related Statutes

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

Amendments, Waivers and Termination. As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. The Authority is not a party to the MSA; accordingly, neither the Authority nor the Borrower has the right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Bondholders are expected to be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on the Authority's ability to make payments to the Bondholders. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Amendments and Waivers" herein.

Reliance on State Enforcement of the MSA and State Impairment. The State may not convey and has not conveyed to the County, the Borrower, the Authority or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled under the MOU to 50% of the State's allocable share of each Annual Payment and Strategic Contribution Fund 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 TSRs for itself or otherwise interfere with the security for the Series 2006 Bonds. In that event, the Bondholders, the Trustee, the Authority, the Borrower or the County may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS" herein.

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

The only material source of payment for the Series 2006 Bonds is the 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 U.S. Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of payments on the Series 2006 Bonds, and Bondholders and Beneficial Owners of the Series 2006 Bonds could incur losses on their investments. Philip Morris, by way of example, prior to the resolution of the dispute in the *Price* case in Illinois in the spring of 2003 over the size of the required appeal bond, had publicly stated that it would not have been possible for it to post the $12 billion bond initially ordered by the trial judge. Philip Morris also publicly stated at that time that there was a risk that immediate enforcement of the judgment would force a bankruptcy. 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 has also filed for bankruptcy relief.

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 County, the Authority, the Borrower, the Trustee, the Bondholders, or the Beneficial Owners of the Series 2006 Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Furthermore, payments previously made to the Bondholders or the Beneficial Owners of the Series 2006 Bonds could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners of the Series 2006 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 County, the Authority, the Borrower, the Trustee, the Bondholders, or the Beneficial Owners of the Series 2006 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 to the Bondholders or the Beneficial Owners of the Series 2006 Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS" herein.

Recharacterization of Transfer of County Tobacco Assets Could Void Transfer

The County and the Borrower, at the time of the execution of the Purchase and Sale Agreement, intended and structured the transfer of the County Tobacco Assets to the Borrower as an absolute sale and not as the grant of a security interest in the County Tobacco Assets to secure a borrowing of the County. However, if the transfer of the County Tobacco Assets were to be recharacterized as part of a borrowing by the County secured by the County Tobacco Assets instead of a sale of the County Tobacco Assets, the transfer of the County Tobacco Assets to the Borrower could be declared void. No assurance can be given that a court would not find that the transfer of the County Tobacco Assets to the Borrower is part of a secured borrowing. Because neither the Borrower nor the Authority has any other funds with which to make payments on the Series 2006 Bonds, the Bondholders could suffer a loss of their entire investment if there were such a judicial finding.

Bankruptcy of the County

The County is a governmental entity and, accordingly, cannot be the subject of an involuntary bankruptcy case under the Bankruptcy Code. The County can become a debtor under the Bankruptcy Code only in a voluntary case. If the County were to become a debtor in a bankruptcy case, and a party in interest (including the County itself) were to take the position that the transfer of the County Tobacco Assets to the Borrower should be recharacterized as the grant of a security interest in the County Tobacco Assets, then delays in payments on the Series 2006 Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Series 2006 Bonds could result. Further, because neither the Borrower nor the Authority has any other funds with which to make payments on the Series 2006 Bonds, the Bondholders and Beneficial Owners could suffer a loss of their entire investment if the transfer from the County to the Borrower is recharacterized as a borrowing and held to be void. See "LEGAL CONSIDERATIONS – Recharacterization of Transfer of County Tobacco Assets Could Void Transfer" herein.

The County, the Borrower, and the Authority have taken steps to minimize the risk that in the event the County were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the Borrower or the Authority be substantively consolidated with those of the County. The Borrower is a separate, special purpose not-for-profit corporation, the organizational documents of which include provisions to the effect that the Borrower shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors, although this restriction may not be enforceable. See "THE

BORROWER" herein. The Authority is a separate special purpose joint powers authority. If a party in interest (including the County itself) were to take the position that the assets and liabilities of the Borrower or the Authority should be substantively consolidated with those of the County, delays in payments on the Series 2006 Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Series 2006 Bonds could result.

Actions could be taken in a bankruptcy of the County which would adversely affect the exclusion of interest on the Series 2006 Bonds from gross income for federal income tax purposes. There may be other possible effects of the bankruptcy of the County that could result in delays or reductions, or elimination of payments on the Series 2006 Bonds. Regardless of any specific adverse determinations in a County bankruptcy proceeding, the fact of a County bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2006 Bonds. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered by Bond Counsel with respect to County bankruptcy matters, see "LEGAL CONSIDERATIONS – Bankruptcy of the County" herein.

Limited Resources of the Authority

The Series 2006 Bonds are limited obligations of the Authority, payable from and secured solely by the Collateral pledged under the Indenture. The Bondholders have no recourse to other assets of the Authority, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Authority related to its Local Agencies other than the County. If, notwithstanding the limitation on recourse described in the preceding sentence, any Bondholders are deemed to have an interest in any asset of the Authority pledged to the payment of other debt obligations of the Authority related to its Local Agencies other than the County, the Bondholders' interest in such asset will be subordinate to the claims and rights of the holders of such other debt obligations and the Indenture will constitute a subordination agreement for purposes of Section 510(a) of the U.S. Bankruptcy Code. Neither the Indenture nor the Series 2006 Bonds creates an indebtedness or liability of any Local Agency of the Authority, including the County, or of the State, for any purpose, including any constitutional or statutory limitations. The Authority's revenues are not funds of the County or of any other Local Agency.

Uncertainty as to Timing of Turbo Redemption

No assurance can be given as to the timing of redemption of the Series 2006 Bonds. No assurance can be given that actual cigarette consumption in the U.S. during the term of the Series 2006 Bonds will be as assumed, or that the other assumptions underlying the Series 2006 Bond Structuring Assumptions (as defined herein), including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Series 2006 Bond Structuring Assumptions, the amount of Collections available to make Turbo Redemption Payments will be affected and the resulting weighted average lives of the Series 2006 Bonds will vary. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2006 Bonds than anticipated will be borne entirely by the Holders of the Series 2006 Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Series 2006 Bonds. No assurance can be given that the structuring assumptions described herein, upon which the projections of the Series 2006 Bonds Turbo Redemptions are based, will be realized.

Limited Obligations of the Authority

The Series 2006 Bonds are limited obligations of the Authority, payable solely from funds held under the Indenture, including payments of Tobacco Settlement Revenues ("**TSRs**"), and earnings on such funds paid or payable to the Authority (the "**Collections**"). The Series 2006 Bonds are not secured by the proceeds thereof, with the exception of proceeds deposited in the Senior Liquidity Reserve Account, which only secures Series 2006 Senior Bonds. The Bonds do not constitute a charge against the general credit of the Authority and under no circumstances will the Authority be obligated to pay interest on or principal or Accreted Value of the

Bonds except from Collections and balances held in the Senior Liquidity Reserve Account (where applicable, and, to the extent available). The Bonds and other obligations of the Authority are not a debt or obligation of the State or any of its municipalities or other political subdivisions, other than the Authority, and neither the State nor any such municipalities or other subdivisions, other than the Authority, shall be liable for the payment of interest on or principal or Accreted Value on the Bonds or such other obligations. The Authority has no taxing power.

Limited Remedies

The Trustee is limited under the terms of the Loan Agreement and the Purchase and Sale Agreement to enforcing the terms of such agreements and to receiving the Collections and applying them in accordance with the Indenture. The Trustee cannot sell or foreclose on its rights to the Collateral or its rights under the Loan Agreement and the Purchase and Sale Agreement. The County, the Borrower and the Authority have not made any representation or warranty that the MSA is enforceable. The MOU provides by its terms that the distribution of tobacco-related recoveries is not subject to alteration by legislative, judicial or executive action at any level and the County has made representations as to the enforceability of the MOU and the ARIMOU. However, such agreements cannot be enforced directly by the Borrower or the Authority. The County has agreed under the Purchase and Sale Agreement to use best reasonable efforts to enforce the MOU and the ARIMOU. Remedies under the Loan Agreement and the Purchase and Sale Agreement do not include the repurchase by the County of the County Tobacco Assets under any circumstances, including unenforceability of the MSA or breach of any representation or warranty. There is no direct right of enforcement by anyone other than the State against the PMs as obligors to make the TSR payments needed to make payments with respect to the Series 2006 Bonds.

Limited Secondary Market of the Series 2006 Bonds; Price Volatility

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

Limitations on Transferability

The Series 2006D Third Subordinate CABs are rated below investment grade upon their issuance. The Series 2006D Third Subordinate CABs are being reoffered only in Authorized Denominations and may only be resold to "qualified institutional buyers" as such term is defined in Rule 144A under the Securities Act of 1933. In addition, each Owner of a Series 2006D Third Subordinate CAB will be deemed to have represented that at the time of the purchase it has holdings equal to at least $1,000,000 in Accreted Value at Maturity Date of Series 2006 Bonds that are not currently rated in an Investment Grade rating category by at least one nationally recognized rating agency; provided, however, that these restrictions on transfer or purchase of the Series 2006D Third Subordinate CABs shall not be applicable at such time as the Series 2006D Third Subordinate CABs are assigned a rating in an "investment grade" rating category by at least one nationally recognized rating agency. Any purchase of such Series 2006D Third Subordinate CABs that does not comport with the representation and agreement deemed to be made pursuant to the Indenture will deprive such Owner or beneficial owner of any right whatsoever to enforce the provisions of the Indenture (any provision of the Indenture to the contrary notwithstanding). See, also "THE SERIES 2006 BONDS - Limitations on Transferability" herein.

"**Investment Grade**" means a rating category without regard to modifiers from: (i) Moody's of at least Baa; (ii) S&P of at least BBB; or (iii) Fitch of at least BBB.

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

Any rating assigned to the Series 2006 Bonds a Rating Agency will reflect such Rating Agency's assessment of the likelihood that owners of such Series 2006 Bonds will receive payments of interest on or principal or Accreted Value on such Series 2006 Bonds when due. Any such rating will not address the likelihood of payments from the Turbo Redemption Account or the expected average life of such Series 2006 Bonds. A rating of such Series 2006 Bonds will not be a recommendation to purchase, hold or sell such Series 2006 Bonds and such rating will not address the marketability of such Series 2006 Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if, in such Rating Agency's judgment circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, such Series 2006 Bonds. No rating has been sought for or assigned to the Series 2006D Third Subordinate CABs.

S&P currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the rated Series 2006 Bonds, have a "negative outlook." Moody's currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the rated Series 2006 Bonds, are "on watch direction uncertain."

LEGAL CONSIDERATIONS

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

Bankruptcy of a PM

Because the only significant source of payment for the Series 2006 Bonds are the 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 Bonds. See "RISK FACTORS – Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of TSRs" herein.

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

Furthermore, payments previously made to the Bondholders or the Beneficial Owners of the Series 2006 Bonds could be avoided as preferential payments, so that the Bondholders and the Beneficial Owners would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the Authority, the Borrower, the County, the Trustee and the Bondholders and Beneficial Owners of the Series 2006 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 Bonds.

Recharacterization of Transfer of County Tobacco Assets Could Void Transfer

The County and the Borrower, at the time of the execution of the Purchase and Sale Agreement, intended and structured the transfer of the County Tobacco Assets to the Borrower in 2002 as an absolute sale and not as the grant of a security interest in the County Tobacco Assets to secure a borrowing of the County. However, if the transfer of the County Tobacco Assets were to be recharacterized as part of a borrowing by the County secured by the County Tobacco Assets instead of a sale of the County Tobacco Assets, the transfer of the County Tobacco Assets to the Borrower could be declared void. No assurance can be given that a court would not find that the transfer of the County Tobacco Assets to the Borrower is part of a secured borrowing. Because neither the Borrower nor the Authority has any other funds with which to make payments on the Series 2006 Bonds, the Bondholders could suffer a loss of their entire investment if there were such a judicial finding.

Bankruptcy of the County

The County is a governmental entity and, accordingly, cannot be the subject of an involuntary bankruptcy case under the Bankruptcy Code. The County can become a debtor under the Bankruptcy Code only in a voluntary case. If the County were to become a debtor in a bankruptcy case, and a party in interest (including the County itself) were to take the position that the transfer of the County Tobacco Assets to the Borrower should be recharacterized as a grant of a security interest in the County Tobacco Assets, then delays in payments on the Series 2006 Bonds could result. If a court were to adopt such position, then delays or reductions, or elimination of, payments on the Series 2006 Bonds could result. Further, because neither the Borrower nor the Authority has any other funds with which to make payments on the Series 2006 Bonds, the Bondholders could suffer a loss of their entire investment if the transaction from the County to the Borrower is recharacterized as a borrowing and held to be void. See "– Recharacterization of Transfer of County Tobacco Assets Could Void Transfer" herein.

Bond Counsel will render an opinion to S&P and Moody's that, subject to all the assumptions, qualifications, and limitations set forth therein, if the County 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 receive payment of the County Tobacco Assets by the County to the Borrower in the form and manner set forth in the Purchase and Sale Agreement would constitute an absolute sale of the right to receive payment of the County Tobacco Assets, rather than a borrowing by the County secured by the right to receive payment of the County Tobacco Assets, so that the right to receive payment of the County Tobacco Assets would not be property of the estate of County 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, but Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court

decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a court would not hold that the transfer of the right to receive payment of the County Tobacco Assets to the Borrower should be recharacterized as the grant of a security interest in the right to receive payment of the County Tobacco Assets, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006 Bonds.

The County, the Borrower, and the Authority have taken steps to minimize the risk that in the event the County were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the Borrower or the Authority be substantively consolidated with those of the County. The Borrower is a separate, special purpose not-for-profit corporation, the organizational documents of which include provisions to the effect that the Borrower shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors, although these provisions may not be enforceable. See "THE BORROWER" herein. The Authority is a separate special purpose joint powers authority. See "THE AUTHORITY" herein.

Bond Counsel will render an opinion to S&P and Moody's that, subject to all the assumptions, qualifications, and limitations set forth therein, if the County 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 the Borrower or the Authority with those of the County. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, but Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that if the County were to become a debtor in a bankruptcy case, a court would not order that the assets and liabilities of the Borrower or the Authority be consolidated with those of the County, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006 Bonds.

Actions could be taken in a bankruptcy of the County which would adversely affect the exclusion of interest on the Series 2006 Bonds from gross income for federal income tax purposes. There may be other possible effects of a bankruptcy of the County that could result in delays or reductions in, or elimination of, payments on the Series 2006 Bonds. Regardless of any specific adverse determinations in a County bankruptcy proceeding, the fact of a County bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2006 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 of TSRs available to the Authority to pay Turbo Redemptions, interest on or principal or Accreted Value of the Series 2006 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 U.S. 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 to dismiss and have proceeded to a stage of litigation where the ultimate outcome may be determined in part by findings of fact based on extrinsic evidence as to the operation and impact of the MSA and appeals are pending or still possible in certain other cases. The terms of the MSA are currently being challenged and may continue to be challenged in the future. A determination by a court that a 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, Bond 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, Bond Counsel will render an opinion to S&P and Moody's 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 under federal and California law among the State 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, Bond Counsel considered the claims asserted in the above-referenced lawsuits (see "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein) as well as other federal and state constitutional and statutory claims which 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. On the Closing Date, Bond Counsel will render an opinion, subject to all the facts, assumptions and qualifications set forth therein, that, although there can be no assurance that a court applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the State's Qualifying Statute to be constitutional and that, while the *Freedom Holdings* decision in the Second Circuit raise some uncertainty over the applicability of the *Parker* immunity and NP immunity defenses that other courts considering the issue have found applicable as a matter of law, would also find the State's Qualifying Statute to be enforceable in all material respects and not violative of antitrust laws. In rendering its enforceability opinion with respect to the State's Qualifying Statute, Bond Counsel will rely without investigation upon a letter from counsel to the OPMs confirming that the OPMs would not dispute that California's Qualifying Statute, if maintained in its current form without modification or addition, is a Qualifying Statute within the meaning of 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.

Enforcement of Rights to TSRs

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

Contractual Remedies. Under State law, settlements are treated as contracts and may be enforced according to their terms. The MOU is a court-approved settlement that establishes the County's right to receive the County Tobacco Assets and to bring suit against the State to enforce its right to receive the County Tobacco Assets. The Purchase and Sale Agreement obligates the County to take all necessary action to protect the Borrower's interest in the County Tobacco Assets. Thus, if the State violates the provisions of the MOU so as to impair the County's right to the County Tobacco Assets, the Trustee, as assignee of the Borrower rights under the Purchase and Sale Agreement, could seek to compel the County to enforce its payment rights under the MOU. Such enforcement costs will be paid from the Operating Account. As interested parties, the Borrower on its own behalf and the Trustee on behalf of the Bondholders could also seek to enforce the County's rights under the MOU, although, since they are not parties to the MOU they may not have enforceable rights to do so.

Fiduciary Relationship Remedies. As the lead California plaintiff in the class action lawsuit underlying the MOU, the State stands in a relationship of faith and trust with the other class members, including the County. Among other fiduciary obligations, the State as lead plaintiff bears a duty to protect faithfully the settlement interests of the other class members. Consequently, action by the State, either unilaterally or by agreement with the OPMs, to amend the MOU, or otherwise impair the County's rights to the County Tobacco Assets without its consent, may constitute a breach of the State's fiduciary duties, but it is likely that the State would deny such a breach and no prediction can be made as to the outcome of such a claim.

Constitutional Claims. The Bondholders are entitled to the benefit of the prohibitions in the U.S. Constitution's Contract Clause against any state's impairment of the obligation of contracts. The State has entered into the MOU and the ARIMOU allocating the State's share of the benefits of the MSA among itself, and Participating Agencies, including the County. Other than certain of the proceeds of the Series 2006 Bonds on deposit in the Accounts, the County Tobacco Assets and money derived therefrom are the sole source of payment for the Series 2006 Bonds.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter the MSA, the MOU or the financing arrangements in a manner that would substantially impair the rights of the Bondholders to be paid

from the County Tobacco Assets. However, to justify the enactment by the State of legislation that substantially impairs the contractual rights of the Bondholders to be paid from the Revenues, the State must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem. In the event that the State demonstrates a significant and legitimate public purpose for such legislation, the State must also show that the impairment of the Bondholders' rights are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Finally, the Bondholders may also have constitutional claims under the Due Process Clauses of the U.S. and State Constitutions.

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 California Qualifying Statute or the enforcement of the right to the TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) on the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amounts available to the Authority or the Borrower to make payments on the Series 2006 Bonds.

THE SERIES 2006 BONDS

The following summary describes certain terms of the Series 2006 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 Bonds. See Appendix F - "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto. Copies of the Indenture may be obtained upon written request to the Trustee.

General

The Authority's "**Series 2006 Bonds**" consist of the "**Series 2006A Senior Current Interest Bonds**," the "**Series 2006B First Subordinate CABs**", the "**Series 2006C Second Subordinate CABs**" and the "**Series 2006D Third Subordinate CABs.**" The Series 2006 Bonds are to be issued pursuant to an Indenture, as supplemented by a Series Supplement, each dated as of May 1, 2006 (the "**Indenture**"), between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "**Trustee**"). The Series 2006A Senior Current Interest Bonds (the "**Series 2006 Senior Bonds**") and any Additional Bonds hereinafter issued pursuant to the Indenture as Senior Bonds (the "**Senior Additional Bonds**") are collectively referred to herein as the "**Senior Bonds.**" "**Additional Bonds**" means Bonds, other than the Series 2006 Bonds and the Additional Subordinate Bonds, issued pursuant to the Indenture for the purposes of refunding in whole or in part any Outstanding Bonds or for any other lawful purpose, subject to certain conditions set forth in the Indenture. See "SECURITY FOR THE SERIES 2006 BONDS - Additional Bonds" herein. The Indenture also permits the issuance of additional First Subordinate Bonds, Second Subordinate Bonds and Third Subordinate Bonds as Additional Bonds, as well as Additional Subordinate Bonds. "**Bonds**" means the Series 2006 Bonds, any Additional Bonds and Additional Subordinate Bonds. "**First Subordinate Bonds**" means the Series 2006B First Subordinate CABs and Additional Bonds identified as First Subordinate Bonds in a Series Supplement. "**Second Subordinate Bonds**" means the Series 2006C Second Subordinate CABs and Additional Bonds identified as Second Subordinate Bonds in a Series Supplement. "**Third Subordinate Bonds**" means the Series 2006D Third Subordinate CABs and Additional Bonds identified as Third Subordinate Bonds in a Series Supplement. "**Additional Subordinate Bonds**" means one or more Series of

Bonds issued for any lawful purpose if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid (as defined herein). Nothing in the Indenture is intended to prohibit the Authority from issuing bonds to refund all Outstanding Bonds under a separate indenture.

The Series 2006 Bonds will initially be represented by one certificate for each maturity of each Series of the Series 2006 Bonds registered in the name of The Depository Trust Company or its nominee ("**DTC**"), New York, New York. DTC will act as securities depository for the Series 2006 Bonds. The Series 2006 Senior Bonds, the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs will be available for purchase in Authorized Denominations in book-entry form only. "**Authorized Denominations**" means: (1) with respect to the Series 2006A Bonds, $5,000 or any integral multiple thereof; (2) with respect to the Series 2006B First Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $5,000 or any integral multiple thereof; (3) with respect to the Series 2006C Second Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $5,000 or any integral multiple thereof, and (4) with respect to the Series 2006D Third Subordinate CABs, denominations such that the Accreted Values thereof at the Maturity Date are in the denomination of $100,000 or any integral multiple of $5,000 in excess thereof. Beneficial Owners of the Series 2006 Bonds will not receive physical delivery of the Series 2006 Bonds. See APPENDIX G- "Book-Entry Only System" attached hereto.

For each Distribution Date, payments will be made to registered owners of the Series 2006 Bonds (the "**Owners**") as of the 15th day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs whether or not such day is a Business Day (the "**Record Date**"). The Trustee and the Authority may establish special record dates for the determination of the Owners for various purposes of the Indenture, including giving consent or direction to the Trustee. Failure to pay the full amount of interest due on a Series 2006 Senior Bond on any Distribution Date will constitute an Event of Default under the Indenture. Failure to pay the full amount of principal or Accreted Value, as applicable, due on a Senior Bond by its Maturity Date will constitute an Event of Default under the Indenture. Failure to pay when due interest or principal or Accreted Value at maturity, as applicable, on a First Subordinate Bond, Second Subordinate Bond or Additional Subordinate Bonds will constitute a Subordinate Payment Default. See "SECURITY FOR THE SERIES 2006 BONDS" herein.

Certain Definitions

"**Current Interest Bond**" means a Bond (including, as the context requires, a Convertible Bond on and after the applicable Conversion Date), the interest on which is payable currently on each Distribution Date.

"**Senior Current Interest Bond**" means a Current Interest Bond that is identified as a Senior Bond in a Series Supplement.

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

"**Capital Appreciation Bond**" means a Bond (including, as the context requires, a Convertible Bond prior to the applicable Conversion Date), the interest on which is compounded on each Distribution Date, commencing on the first Distribution Date after its issuance through (1) and including the Maturity Date or earlier redemption date of such Bond in the case of a Capital Appreciation Bond which is not a Convertible Bond, or (2) and excluding the Conversion Date or including any earlier redemption date in the case of a Convertible Bond.

"**Convertible Bond**" means a Capital Appreciation Bond which is deemed to be a Current Interest Bond after the applicable Conversion Date.

"**Senior Convertible Bond**" means a Convertible Bond that is identified as a Senior Bond in a Series Supplement.

"**Conversion Date**" means the date set forth in the applicable Series Supplement on and after which a Convertible Bond is deemed a Current Interest Bond and after which the Owners shall be entitled to current payments of interest on each Distribution Date.

"**Accreted Value**" means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest accrued thereon from its date compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through and including the Maturity Date or earlier redemption date of such Bond, or in the case of a Convertible Bond, through and excluding the applicable Conversion Date or through and including any earlier redemption date of such Bond) at the "original issue yield" for such Bond, as set forth in the related Series Supplement or in an exhibit thereto; provided, however, that the Authority shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the related Series Supplement or in an exhibit thereto by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Dates. The term "**original issue yield**" means, with respect to any particular Bond, the yield to the applicable Maturity Date of such Bond from the initial date of delivery thereof calculated on the basis of semiannual compounding on each Distribution Date.

"**Bond Obligation**" means, as of any given date of calculation, (a) with respect to any Outstanding Current Interest Bond, the principal amount of such Current Interest Bond, and (b) with respect to any Outstanding Capital Appreciation Bond, the Accreted Value thereof as of such date.

Payments of Interest

Interest on the Series 2006A Senior Current Interest Bonds shall accrue from their dated date, which interest is payable currently on each Distribution Date, commencing with the first Distribution Date after their issuance through and including the Maturity Date or earlier redemption date of such Bonds. Interest on the Series 2006A Senior Current Interest Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Failure to pay the full amount of interest due on the Series 2006A Senior Current Interest Bonds on any Distribution Date is an Event of Default. See "SECURITY FOR THE SERIES 2006 BONDS - Events of Default" herein.

Interest on the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs shall accrete from the dated date thereof and shall be compounded on each Distribution Date, commencing with the first Distribution Date after their issuance through and including the Maturity Date or earlier redemption date of such Bond.

Interest on the Series 2006 Bonds is capitalized through December 1, 2006.

See "SECURITY FOR THE SERIES 2006 BONDS - Application of Collections - Distribution Date Transfers" herein.

Payments of Principal or Accreted Value on Turbo Term Bond Maturities

The Series 2006 Bonds are all issued as Turbo Term Bonds and are subject to payment from Sinking Fund Installments, if applicable, and Turbo Redemptions as described below. The principal or Accreted Value of a Series 2006 Senior Bond must be paid by its stated Maturity Date to avoid an Event of Default under the Indenture. The Accreted Value of the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs and the Series 2006D Third Subordinate CABs must be paid by their stated Maturity Dates to avoid a Subordinate Payment Default under the Indenture. "**Subordinate Payment Default**" means a failure to pay when due the Accreted Value at maturity on any First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds or Additional Subordinate Bonds. "**Maturity Date**" means, with respect to any Bond, the final date by which all remaining principal or Accreted Value of such Bond is due and payable.

Sinking Fund Installments

"**Sinking Fund Installments**" means each respective payment of principal or Accreted Value to be made on Turbo Term Bonds that are Senior Bonds scheduled to be made from amounts available therefor in the Senior Debt Service Account and the Partial Lump Sum Payment Account, as such schedule is set forth in a Series Supplement. Amounts in the Senior Liquidity Account are not available to make Sinking Fund Installments. Failure by the Authority to pay the Sinking Fund Installments when such Sinking Fund Installments are scheduled will not constitute an Event of Default under the Indenture to the extent that such failure results from the insufficiency of available Collateral to make such payment therefor.

Sinking Fund Installments for
Series 2006A Senior Current Interest Bonds
Maturing on June 1, 2025

June 1	Sinking Fund Installment	June 1	Sinking Fund Installment
2008	$2,140,000	2017	$5,410,000
2009	2,600,000	2018	8,065,000
2010	3,045,000	2019	8,820,000
2011	3,535,000	2020	8,730,000
2012	2,860,000	2021	9,155,000
2013	3,315,000	2022	9,605,000
2014	3,785,000	2023	10,070,000
2015	4,265,000	2024	10,560,000
2016	4,825,000	2025	11,075,000

Sinking Fund Installments for
Series 2006A Senior Current Interest Bonds
Maturing on June 1, 2037

June 1	Sinking Fund Installment	June 1	Sinking Fund Installment
2026	$11,625,000	2032	$15,695,000
2027	12,225,000	2033	16,500,000
2028	12,850,000	2034	17,345,000
2029	13,510,000	2035	18,235,000
2030	14,200,000	2036	19,170,000
2031	14,930,000	2037	20,155,000

Sinking Fund Installments for
Series 2006A Senior Current Interest Bonds
Maturing on June 1, 2046

June 1	Sinking Fund Installment	June 1	Sinking Fund Installment
2038	$21,205,000	2043	$27,395,000
2039	22,320,000	2044	28,840,000
2040	23,490,000	2045	30,355,000
2041	24,725,000	2046	31,950,000
2042	26,030,000		

Turbo Redemptions

Under the Indenture, 100% of all Collections which are in excess of the requirements for, among other things, the periodic funding of Operating Expenses, interest payments due on Outstanding Bonds, Sinking Fund Installments, Turbo Term Bond Maturities and replenishment of the Senior Liquidity Reserve Account ("**Surplus Collections**") are applied to the mandatory redemption of the Series 2006 Bonds at the principal amount or Accreted Value thereof on each Distribution Date (or a special redemption date pursuant to the Indenture) in accordance with the Payment Priorities defined herein ("**Turbo Redemptions**"). Turbo Redemptions may also be made in accordance with the Payment Priorities from amounts on deposit in the Partial Lump Sum Payment Account with a Rating Confirmation with respect to any Senior Bonds which are then rated by a Rating Agency. Amounts in the Senior Liquidity Reserve Account are not available to make Turbo Redemptions. "**Turbo Term Bond Maturity**" means the payment of principal or Accreted Value required to be made upon the Maturity Date of any Turbo Term Bond, as such schedule is set forth in a Series Supplement.

Turbo Redemptions, if any, of the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, will not occur until the Senior Bonds are Fully Paid. Turbo Redemptions, if any, of the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, will not occur until the Senior Bonds and First Subordinate Bonds, including the Series 2006B First Subordinate CABs, are Fully Paid. Turbo Redemptions, if any, of the Third Subordinate Bonds, including the Series 2006D Third Subordinate CABs, will not occur until the Senior Bonds, the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, and the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, are Fully Paid. Turbo Redemptions of the Current Interest Bonds shall be at a redemption price of par, plus interest accrued to the date of redemption. Turbo Redemptions of Capital Appreciation Bonds shall be applied to redeem such Bonds at their Accreted Value as of the redemption date without premium. If less than all of the Turbo Term Bonds are to be redeemed, the Owners of such Turbo Term Bonds shall be paid in accordance with the Indenture. Moneys in any Pledged Account shall not be used to make open market purchases of Turbo Term Bonds.

Failure to make Turbo Redemptions will not constitute an Event of Default under the Indenture to the extent that such failure results from the insufficiency of available Collateral to make such payment therefor.

Projected Turbo Redemptions*

Turbo Redemption Date (June 1)	Series 2006A Senior Current Interest Bonds Maturing June 1, 2025	Series 2006A Senior Current Interest Bonds Maturing June 1, 2037	Series 2006A Senior Current Interest Bonds Maturing June 1, 2046
2007	$ 6,375,000		
2008	9,310,000		
2009	10,200,000		
2010	11,090,000		
2011	12,045,000		
2012	11,585,000		
2013	12,535,000		
2014	13,520,000		
2015	14,540,000		
2016	10,660,000	$ 5,025,000	-
2017		16,905,000	-
2018		20,710,000	-
2019		22,215,000	-
2020		23,785,000	-
2021		25,475,000	-
2022		27,880,000	-
2023		29,805,000	-
2024		14,640,000	$17,200,000
2025		-	34,050,000
2026		-	36,385,000
2027		-	38,860,000
2028		-	41,470,000
2029		-	68,345,000
2030			
2031			
2032			
2033			
2034			
2035			
2036			
2037			
2038			
2039			
2040			
2041			
2042			

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

Projected Turbo Redemptions*

Turbo Redemption Date (June 1)	Series 2006B First Subordinate CABS Maturing June 1, 2046	Series 2006C Second Subordinate CABS Maturing June 1, 2046	Series 2006D Third Subordinate CABS Maturing June 1, 2046
2007			
2008			
2009			
2010			
2011			
2012			
2013			
2014			
2015			
2016			
2017			
2018			
2019			
2020			
2021			
2022			
2023			
2024			
2025			
2026			
2027			
2028			
2029	$ 8,879,917	-	-
2030	45,407,212	-	-
2031	33,764,818	$12,246,025	-
2032	-	31,646,880	$15,769,045
2033	-	-	48,039,842
2034	-	-	48,672,653
2035	-	-	28,694,874
2036			
2037			
2038			
2039			
2040			
2041			
2042			

* Turbo Redemptions of Series 2006B First Subordinate CABs, Series 2006C Second Subordinate CABs and Series 2006D Third Subordinate CABs are shown at the Accreted Value thereof. Assumes Turbo Redemptions are made based on the receipt of Surplus Collections in accordance with the Global Insight Base Case Forecast and other structuring assumptions. No assurance can be given that these structuring assumptions will be realized. See "OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

The ratings of the Series 2006 Bonds only address each Rating Agency's assessment of the ability of the Authority to pay interest when due and to pay principal or Accreted Value of the Series 2006 Senior Bonds by their respective Maturity Dates and do not address payment at any earlier time, whether from Turbo Redemptions as described herein or otherwise. See "RATINGS" herein.

Redemptions Credited by Payment Priorities

All redemptions made under the Indenture will be in accordance with the following order of priority (collectively, the "**Payment Priorities**"): (1) first, the Senior Bonds are Fully Paid in chronological order of Serial Maturities, Sinking Fund Installments and Maturity Dates therefor; (2) second, the First Subordinate Bonds are Fully Paid; (3) third, the Second Subordinate Bonds are Fully Paid; (4) fourth, the Third Subordinate Bonds are Fully Paid; and (5) fifth, any Additional Subordinate Bonds are Fully Paid in accordance with the provisions of the applicable Series Supplement. Within a Payment Priority, redemptions made under the Indenture will be credited as follows: (i) the amount of any Turbo Redemptions shall be credited against both Sinking Fund Installments and Turbo Term Bond Maturities for the Turbo Term Bonds in the order of priority and within a priority in direct chronological order as provided in the applicable Series Supplement; and (ii) the amount of any Sinking Fund Installments made shall be credited against Turbo Term Bond Maturities for the Turbo Term Bonds in the order of priority and within a priority in direct chronological order as provided in the applicable Series Supplement; provided, however, that Sinking Fund Installments scheduled for the same date shall be credited Pro Rata regardless of the maturity date of the related Term Bond Maturity.

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

No payments will be made with respect to the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, before the Senior Bonds are paid or redeemed in full. No payments will be made with respect to the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, before the Senior Bonds and First Subordinate Bonds, including the Series 2006B First Subordinate CABs, are paid or redeemed in full. No payments will be made with respect to the Third Subordinate Bonds, including the Series 2006D Third Subordinate CABs, before the Senior Bonds, the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, and the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, are paid or redeemed in full. Even if there has been a Subordinate Payment Default, the Owners of the First Subordinate Bonds, including the Series 2006B First Subordinate CABs, may not enforce the provisions of the Indenture for their benefit by appropriate legal proceedings unless or until the Senior Bonds are no longer Outstanding. Similarly, (i) the Owners of the Second Subordinate Bonds, including the Series 2006C Second Subordinate CABs, may not enforce the provisions of the Indenture for their benefit unless or until the Senior Bonds and the First Subordinate Bonds are no longer Outstanding and (ii) the Owners of the Third Subordinate Bonds, including the Series 2006D Third Subordinate CABs, may not enforce the provisions of the Indenture for their benefit unless or until the Senior Bonds, the First Subordinate Bonds and the Second Subordinate Bonds are no longer Outstanding.

Mandatory Clean-up Call

The Series 2006 Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the Bond Obligation being redeemed plus interest accrued or accreted to the redemption date at any time that the available amounts on deposit in the Pledged Accounts equal or exceed the aggregate Bond Obligation of, and accrued interest on, all Outstanding Bonds. "**Pledged Accounts**" means 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 Senior Debt Service Account, the Partial Lump Sum Payment Account, the Senior Liquidity Reserve Account, the Senior Turbo Redemption Account, the First Subordinate Turbo Redemption Account, the Second Subordinate Turbo Redemption Account and the Third Subordinate Turbo Redemption Account. The term "Pledged Accounts" shall also include all subaccounts contained in the named accounts. See Appendix F - "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

Optional Redemption

The Series 2006A Senior Current Interest Bonds are subject to redemption at the option of the Authority (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 Turbo Term Bonds, and (2) in whole or in part on any date on or after June 1, 2014, from any Maturity Date selected by the Authority in its discretion and on such basis as the Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the principal amount being redeemed, plus interest accrued to the redemption date.

The Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, and the Series 2006D Third Subordinate CABs are subject to redemption at the option of the Authority (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 Turbo Term Bonds, and (2) in whole or in part on any date on or after June 1, 2014, from any Maturity Date selected by the Authority in its discretion and on such basis as the Trustee shall deem fair and appropriate, including by lot, within a Maturity Date, in either case at a redemption price equal to 100% of the Accreted Value on the redemption date.

Other than as provided above, the Series 2006 Bonds shall be redeemable prior to maturity in accordance with their terms and the terms of the Indenture.

If the Authority establishes a defeasance escrow for the Series 2006 Bonds, then Turbo Term Bonds shall be retired in accordance with the Optional Redemption provisions described above, and in amounts that shall be determined by reference to the Projected Turbo Redemptions (see the chart under the caption "THE SERIES 2006 BONDS - Projected Turbo Redemptions") that, as of the date of such redemption, were projected to but have not been paid with respect to such Turbo Term Bonds. Any such redemption, in whole or in part, shall be from any maturity selected by the Authority in its discretion and, within a maturity, on a Pro Rata basis. See Appendix F — "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS — INDENTURE" attached hereto.

Notice of Redemption

When a Bond is to be redeemed prior to its stated Maturity Date, the Trustee will give notice to the Owner thereof in the name of the Authority, which notice will identify the Bond to be redeemed, state the date fixed for redemption, and state that such Bond will be redeemed at the Corporate Trust Office of the 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 or accreted to the redemption date, and that money therefor having been deposited with the Trustee or Paying Agent, from and after such date, interest thereon will cease to accrue or accrete. The Trustee will give at least 15 days notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any 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 Trustee by the Authority no later than five days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same

persons, as notice of such redemption was given as described above. In making the determination as to how much money will be available in the Senior Turbo Redemption Account, the First Subordinate Turbo Redemption Account, the Second Subordinate Turbo Redemption Account or the Third Subordinate Turbo Redemption Account on any Distribution Date for the purpose of giving notice of redemption, the Trustee shall take into account investment earnings and amounts to be transferred from the Senior Liquidity Reserve Account to the Senior Turbo Redemption Account or the First Subordinate Turbo Redemption Account which it reasonably expects to be available for application.

Selection of Bonds for Redemption

Unless otherwise specified herein or by Series Supplement, if less than all the Outstanding Bonds of like Series, interest rate and Maturity Date are to be redeemed, the particular Bonds to be redeemed shall be selected by the Trustee by such method as it shall deem fair and appropriate, including by lot, and which may provide for the selection for redemption of portions (equal to any Authorized Denominations) of the principal or Accreted Value of Bonds of a denomination larger than the minimum Authorized Denomination. Turbo Redemptions of Capital Appreciation Bonds shall be credited against the amount Outstanding at the Accreted Value thereof. Upon surrender of any Capital Appreciation Bond redeemed in part only, the Authority shall execute and the Trustee shall authenticate and deliver to the Owner thereof, at the expense of the Authority, a new Capital Appreciation Bond of Authorized Denominations equal to the Accreted Value Outstanding on the date set for redemption after deducting the Accreted Value to be redeemed on such date. In determining these amounts, the Trustee may compute: (x) the Accreted Value outstanding per Authorized Denomination on the date set for redemption; (y) the number of Authorized Denominations to be redeemed on the date set for redemption at the Accreted Value thereof from the amounts available for such redemption; and (z) the number of Authorized Denominations to remain Outstanding after the redemption.

Limitations on Transferability

The Series 2006D Third Subordinate CABs shall be transferred only to Qualified Institutional Buyers (as defined below) and only in Authorized Denominations and shall be subject to the following transfer restrictions; provided, however, that these restrictions on transfer or purchase of the Series 2006D Third Subordinate CABs shall not be applicable at such time as the Series 2006D Third Subordinate CABs are assigned a rating in an Investment Grade category.

Each Owner and beneficial owner of a Series 2006D Third Subordinate CABs, by its purchase thereof, shall be deemed to have represented and agreed as set forth below, as applicable:

(i) *Qualified Institutional Buyer.* Such Owner or beneficial owner (A) is a "qualified institutional buyer" as defined in Rule 144(a)(1) promulgated under the United States Securities Act of 1933, as amended (a "Qualified Institutional Buyer"); and (B) is acquiring such Series 2006D Third Subordinate CABs for its own account or for the account of a Qualified Institutional Buyer.

(ii) *Aggregate Investment not less than $1,000,000 Accreted Value at Maturity Date.* As of the date of its purchase of such Series 2006D Bond, such Owner or beneficial owner has holdings amounting to at least $1,000,000 in Accreted Value at Maturity Date of Series 2006 Bonds that are not currently rated in an Investment Grade rating category by at least one nationally recognized rating agency, it being understood that any purchase that does not comport with the representation and agreement deemed to be made pursuant to this clause (ii) shall deprive such Owner or beneficial owner of any right whatsoever to enforce the provisions of the Indenture (any provision of the Indenture to the contrary notwithstanding).

(iii) *Future Transfers.* Such Owner or beneficial owner agrees that, if in the future it decides to offer, resell, pledge or otherwise transfer such Series 2006D Third Subordinate CABs, (A) such Series 2006D Third Subordinate CABs may be offered, resold, pledged or otherwise transferred only to a Qualified Institutional Buyer; and (B) it shall, and each subsequent Owner or beneficial owner is required to, notify any subsequent

purchaser of such Series 2006D Third Subordinate CABs from it of the resale restrictions provided for in the Series Supplement and described herein.

SECURITY FOR THE SERIES 2006 BONDS

General

The Series 2006 Bonds are primarily secured by all of the right, title and interest in and to the portion of the payment of TSRs required to be made under the MSA entered into by the PMs that have been allocated by the State to the County.

Purchase of County Tobacco Assets. Pursuant to the Purchase and Sale Agreement, the County sold to the Borrower and the Borrower purchased from the County, all right, title and interest of the County in, to and under the MOU, the ARIMOU, the MSA and the Consent Decree, including without limitation, the rights of the County to be paid the money due to it under the MOU, the ARIMOU, the MSA and the Consent Decree from and after January 4, 2002 (previously defined as the "County Tobacco Assets"). The California Escrow Agent was irrevocably instructed, pursuant to the ARIMOU, to disburse all of the County Tobacco Assets from the California Escrow to the 2001 Indenture Trustee. In connection with the issuance of the Series 2006 Bonds, the California Escrow Agent will be irrevocably instructed by the County and the Borrower to disburse the County Tobacco Assets from the California Escrow Account directly to the Trustee. Pursuant to the ARIMOU Amendment and instructions of the County to the State Attorney General, the MOU Proportional Allocable Share attributable to the County will be transferred directly to the Trustee as long as the Bonds are outstanding. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - PURCHASE AND SALE AGREEMENT" attached hereto.

Loan Agreement. Pursuant to the Loan Agreement, the Authority will loan the proceeds of the Series 2006 Bonds to the Borrower. Under the Loan Agreement, the Borrower has pledged and assigned and granted to the Authority, a first priority perfected security interest in all right, title and interest of the Borrower, whether now owned or hereafter acquired, in, to and under the following property: (a) the County Tobacco Assets purchased from the County, (b) to the extent permitted by law (as to which no representation is made) corresponding present or future rights, if any, of the Borrower to enforce or cause the enforcement of payment of such pledged County Tobacco Assets pursuant to the MOU and the ARIMOU, (c) the corresponding rights of the Borrower under the Purchase and Sale Agreement, and (d) all proceeds of any and all of the foregoing (collectively, the "**Corporation Tobacco Assets**").

Indenture. To secure payment of the Bonds and the Swap Payments, all with the respective priorities specified in the Indenture, the Authority will pledge to the Trustee, and grant to the Trustee a first priority lien and security interest in the "**Collateral**," consisting of all of the Authority's right, title, and interest, whether now owned or hereafter acquired, in, to, and under: (i) the Authority's rights with respect to the Loan Agreement, including but not limited to the right to receive Loan Payments and to enforce the obligations of the Borrower pursuant to the Loan Agreement; (ii) the Corporation Tobacco Assets; (iii) the Pledged Accounts, all money, instruments, investment property, or other property credited to or on deposit in the Pledged Accounts, and all investment earnings thereon; (iv) any payment received by the Authority pursuant to a Swap Contract ("**Swap Contract**" means an interest rate exchange, cap, collar, hedge or similar agreement entered into by the Authority in connection with Senior Bonds); (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, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (vi) all proceeds of the foregoing. The Collateral does not include the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the

Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Owners. The Authority 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, the cost thereof to be an Operating Expense. None of the proceeds of the Bonds or any earnings therefrom, unless deposited into one of the Pledged Accounts, shall in any way be pledged to the payment of the Bonds. Such amounts shall not be part of the Collateral. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - INDENTURE" attached hereto.

Defeasance. When, among other conditions set forth in the Indenture (including required notices) 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 Indenture, all obligations to Owners in whole (to be verified by a nationally recognized firm of independent verification agents) then, such Owners (and counterparties to Swap Contracts) shall 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, the Indenture and the lien, rights and security interests created by the Indenture (except in such funds and investments) shall terminate and become null and void, and the Authority and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien, rights and security interests (except in such funds and investments) created by the Indenture. Upon such defeasance, the funds and investments required to pay or redeem the Series 2006 Bonds shall be irrevocably set aside for that purpose, subject, however, to the terms of the Indenture, and money held for defeasance shall be invested only as provided in the Indenture and applied by the Trustee and other Paying Agents, if any, to the retirement of the Series 2006 Bonds. Any funds or other property held by the Trustee and not required for payment or redemption of the Bonds shall be distributed in accordance with the order of the Authority.

Defeasance of Turbo Term Bonds. Subject to the requirements of federal tax law and to the right of the Authority to defease the Series 2006 Bonds in accordance with the optional redemption provisions of the Indenture, when Series 2006 Bonds are to be defeased, the defeasance escrow will be structured to redeem the Series 2006 Bonds in accordance with the Projected Turbo Redemptions schedule until any optional redemption of the Series 2006 Bonds so that the defeased Turbo Term Bonds will not be redeemed more slowly than the Pro Rata Defeasance Redemption Schedule calculated pursuant to the Indenture.

The provisions of the Indenture with respect to defeasance of Turbo Term Bonds shall not be construed to limit the optional redemption of Bonds pursuant to the applicable Series Supplement.

Senior Liquidity Reserve Account

The Senior Liquidity Reserve Account will be established and maintained by the Trustee and initially funded from proceeds of the issuance of the Series 2006 Bonds in an amount equal to $33,274,125.00 (the "**Senior Liquidity Reserve Requirement**"), which shall be maintained for so long as any Series 2006 Bonds Senior Bonds are Outstanding (and zero thereafter), which amount may (but is not required to) be amended upon the issuance of Additional Bonds that constitute Senior Bonds in accordance with the applicable Series Supplement. Amounts in the Senior Liquidity Reserve Account will be available to pay interest on Senior Bonds and Swap Payments, Series Maturities or Turbo Term Bond Maturities on Senior Bonds but will not be available for Sinking Fund Installments or Turbo Redemptions on such Bonds. Unless an Event of Default has occurred, while any Senior Bonds are Outstanding, Collections (to the extent available) will be used to replenish the Senior Liquidity Reserve Account to the Senior Liquidity Reserve Requirement.

On any Distribution Date on which the amount on deposit in the Senior Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Senior Liquidity Reserve Account, including a Termination Payment) equals or exceeds the principal or Accreted Value of and interest on all Outstanding Senior Bonds, the amount on deposit in the Senior Liquidity Reserve Account first shall be transferred to the Senior Turbo Redemption Account and applied to the Turbo

Redemption of all Outstanding Senior Bonds, and second shall be transferred to the First Subordinate Turbo Redemption Account and applied to the Turbo Redemption of Outstanding First Subordinate Bonds.

Limited Obligations

The Series 2006 Bonds are limited obligations of the Authority, payable solely from funds held under the Indenture, including the Collections. The Series 2006 Bonds are not secured by the proceeds thereof, with the exception of proceeds deposited in the Capitalized Interest Subaccount, and those deposited in the Senior Liquidity Reserve Account, which only secures Series 2006 Senior Bonds. The Bonds do not constitute a charge against the general credit of the Authority and under no circumstances will the Authority be obligated to pay the interest on or principal or Accreted Value of or redemption premiums, if any, on the Bonds except from Collections and balances held in the Senior Liquidity Reserve (where applicable, and, to the extent available). The Bonds and other obligations of the Authority are not a debt or obligation of the State or any of its municipalities or other political subdivisions, other than the Authority, and neither the State nor any such municipalities or other subdivisions, other than the Authority, shall be liable for the payment of the principal or Accreted Value of or interest on the Bonds or such other obligations. The Authority has no taxing power.

Payment Priorities

The Series 2006 Bonds are redeemed through Turbo Redemptions paid in the order of the Payment Priorities, as set forth in the Indenture. See THE SERIES 2006 BONDS - Redemptions Credited by Payment Priorities" herein.

Application of Collections

General. All Collections received by the Trustee, excluding investment earnings on amounts on deposit in Accounts with the Trustee under the Indenture, will be promptly deposited by the Trustee into the Collections Account. All Collections that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account, in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. All Collections that have been identified by an Officer's Certificate as consisting of Total Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied as described under "Transfers to Accounts" below, in accordance with the instructions received by the Trustee pursuant to an Officer's Certificate. In addition, immediately preceding the time when the application of funds on deposit in the Collections Account is made pursuant to the following paragraph, the Trustee shall deposit in the Collections Account and apply as described in the following paragraph all Collections consisting of investment earnings available on such date on amounts on deposit with the Trustee under the Indenture (excluding amounts in the Costs of Issuance Account, the Rebate Account, the Operating Account, the Operating Contingency Account and the Partial Lump Sum Payment Account), except that all amounts in the Senior Liquidity Reserve Account in excess of the Senior Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Indenture, taking into account investment earnings and other amounts available on such date, shall be transferred to the Senior Debt Service Account (except as otherwise provided under "*Transfers to Accounts*" below) and all investment earnings available on such date in the Capitalized Interest Subaccount shall be maintained in the Senior Debt Service 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 Trustee will withdraw the funds on deposit in the Collections Account and transfer such amounts as follows:

(i) to the Operating Account, an 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 Senior 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 Senior 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 Senior Bonds and 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) and (iv) under "*Distribution Date Transfers*" below;

(iii) to the Senior 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, Sinking Fund Installment or Term Bond Maturity (including Turbo Term Bond Maturities) if any, due for Senior Bonds in or scheduled for the next succeeding Bond Year, plus (b) any Serial Maturities, Sinking Fund Installments or Term Bond Maturities (including Turbo Term Bond Maturity) unpaid from prior Distribution Dates, provided that the amount of each Sinking Fund Installment and Turbo Term Bond Maturities shall first be adjusted to account for prior principal payments ("**Term Bond Maturity**" means the payment of principal or Accreted Value required to be made upon the Maturity Date of any Term Bond, as such schedule is set forth in a Series Supplement.);

(iv) unless an Event of Default has occurred, to the Senior Liquidity Reserve Account, an amount sufficient to cause the amount on deposit therein to equal the Senior Liquidity Reserve Requirement, provided that on any Distribution Date on which the amount on deposit in the Senior Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Senior Liquidity Reserve Account, including a Termination Payment) equals or exceeds the principal or Accreted Value of and interest on all Outstanding Senior Bonds, the amount on deposit in the Senior Liquidity Reserve Account first shall be transferred to the Senior Turbo Redemption Account and applied to the Turbo Redemption of all Outstanding Senior Bonds, and second shall be transferred to the First Subordinate Turbo Redemption Account and applied to the Turbo Redemption of Outstanding First Subordinate Bonds;

(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;

(vi) to the Senior Turbo Redemption Account, all amounts remaining in the Collections Account until no Senior Bonds are Outstanding;

(vii) to the First Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no First Subordinate Bonds are Outstanding;

(viii) to the Second Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Second Subordinate Bonds are Outstanding; and

(ix) to the Third Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Third Subordinate Bonds are Outstanding.

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

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

(ii) from the Senior Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, the Serial Maturity, Sinking Fund Installment and Term Bond Maturity (including Turbo Term Bond Maturity) for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Sinking Fund Installment and Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Sinking Fund Installment or Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iii) from the Senior Liquidity Reserve Account, to pay, in the following order, the Serial Maturity and Term Bond Maturity (including Turbo Term Bond Maturity), if any, for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iv) from the Senior Turbo Redemption Account, to redeem Senior Bonds which are Turbo Term Bonds on such Distribution Date (or a special redemption pursuant to the Indenture), provided that all Senior Bonds shall be redeemed in accordance with clause (1) of the Payment Priorities;

(v) from the Partial Lump Sum Payment Account, but only as directed in an Officer's Certificate delivered by the Authority and accompanied by Rating Confirmation with respect to any Senior Bonds which are then rated by a Rating Agency, to redeem Turbo Term Bonds on such Distribution Date (or a special redemption pursuant to the Indenture) in accordance with Turbo Redemption provisions of the Indenture, provided that any redemptions shall redeem Bonds in accordance with the Payment Priorities;

(vi) from the First Subordinate Turbo Redemption Account, to redeem First Subordinate Bonds on such Distribution Date (or a special redemption date pursuant to the Indenture) in accordance with the Indenture;

(vii) from the Second Subordinate Turbo Redemption Account, to redeem Second Subordinate Bonds on such Distribution Date in accordance with the Indenture; and

(viii) from the Third Subordinate Turbo Redemption Account, to redeem Third Subordinate Bonds on such Distribution Date in accordance with the Indenture.

Extraordinary Prepayment Upon an Event of Default. 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:

(i) until the Senior Bonds are no longer Outstanding, the Trustee will apply all funds in the Senior Debt Service Account, the Senior Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Senior Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Senior Current Interest Bonds (including the Senior Convertible Bonds after the Conversion Date) and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, second, principal or Accreted Value of all Senior Bonds then Outstanding;

(ii) until the First Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the First Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all First Subordinate Bonds then Outstanding;

(iii) until the Second Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Second Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all Second Subordinate Bonds;

(iv) until the Third Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Third Subordinate Turbo Redemption Account to pay Pro Rata the principal and interest or the Accreted Value on all Third Subordinate Bonds

(v) the application of funds with respect to Additional Subordinate Bonds shall be in accordance with the provisions of the applicable Series Supplement; and

(vi) notwithstanding anything to the contrary in the Indenture, the value of any Capital Appreciation Bonds that are Series 2006 First Subordinate Bonds, Series 2006 Second Subordinate Bonds or Series 2006 Third Subordinate Bonds shall continue to accrete at the Default Rate (including accretion on any unpaid Accreted Value), to the extent legally permissible, after the Maturity Date for such Bonds if not Fully Paid on the Maturity Date.

"**Default Rate**" means the rate of interest per annum set forth in a Series Supplement at which the First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds will accrete on and during the continuance of a Subordinate Payment Default for such Bonds.

"**Pro Rata**" means, for an allocation of available amounts to any payment of interest, Accreted Value, 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 the Authority 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.

Total Lump Sum Payment. Upon the receipt of a Total Lump Sum Payment, the 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 Payments to make the following payments, each Pro Rata, in the following order of priority:

(i) pay the accrued interest on the Senior Current Interest Bonds (including Senior Convertible Bonds after the Conversion Date) and Swap Payments (including interest at the stated rate on any unpaid interest, to the extent legally permissible);

(ii) pay principal or Accreted Value on all Series 2006 Senior Bonds then Outstanding;

(iii) pay principal and interest or Accreted Value on all First Subordinate Bonds then Outstanding;

(iv) pay principal and interest or Accreted Value on all Second Subordinate Bonds then Outstanding;

(v) pay principal and interest or Accreted Value on all Third Subordinate Bonds Outstanding; and

(vi) pay Additional Subordinate Bonds in accordance with the provisions of the applicable Series Supplement.

After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds and no obligations to make Swap Payments under a Swap Contract, the Trustee shall deliver any amounts remaining in a Fund or Account in accordance with the order of the Authority.

Funds in the Operating Account shall be applied by the Trustee at any time, in accordance with directions in an Officer's Certificate pursuant to the Indenture, to pay Operating Expenses (other than Termination Payments), or to fund an account of the Authority or the Borrower free and clear of the lien of the Indenture for purposes of paying such Operating Expenses.

Funds in the Operating Contingency Account shall be applied by the Trustee at any time, in accordance with directions in an Officer's Certificate pursuant to the Indenture, to pay Operating Expenses not otherwise paid from the Operating Account, or to fund an account of the Authority or the Borrower free and clear of the lien of the Indenture for purposes of paying such Operating Expenses.

Non-Impairment Covenants

The Authority shall diligently pursue any and all actions to enforce its rights in the Collateral and under each instrument or agreement included therein, and shall 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.

Events of Default

The occurrence of any of the following events will constitute an "Event of Default" under the Indenture: (i) failure to pay when due any Swap Payment or interest on any Senior Bonds; (ii) failure to pay when due any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds; or (iii) failure of the Authority to observe or perform any other covenant, condition, agreement, or provision contained in the Senior Bonds or in the Indenture relating to Senior Bonds, which breach is not remedied within 60 days after Written Notice, specifying such default and requiring the same to be remedied, shall have been given to the Authority by the Trustee or by the Owners of at least 25% in Bond Obligation of the Senior Bonds then Outstanding. In the case of a default specified in (iii) above, if the default be such that it cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the default is corrected. Except as specified in subsections (i) and (ii) of this paragraph, failure to make any payment or to make provision therefor, including 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 to make such payment or provision therefor. See "Extraordinary Prepayment Upon an Event of Default" herein.

A Subordinate Payment Default is not an Event of Default under the Indenture, provided that in the event of a Subordinate Payment Default, Owners of First Subordinate Bonds, Second Subordinate Bonds or Additional Subordinate Bonds shall have certain remedies set forth in the Indenture. The Owners of First Subordinate Bonds may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings in accordance with the Payment Priorities only if Senior Bonds are no longer Outstanding. The Owners of Second Subordinate Bonds may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings in accordance with the Payment Priorities only if Senior Bonds and First Subordinate Bonds are no longer Outstanding. The Owners of Third Subordinate Bonds may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings in accordance with the Payment Priorities only if Senior Bonds, First Subordinate Bonds and Second Subordinate Bonds are no longer Outstanding. The Owners of Additional Subordinate Bonds may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings in accordance with the Payment Priorities only if Senior Bonds, First Subordinate Bonds, Second Subordinate Bonds and Third Subordinate Bonds are no longer Outstanding. See Appendix F – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - INDENTURE - Remedies for

First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds" attached hereto. Neither the Trustee nor the Owners have the right to sell or foreclose on the Collateral or the rights of the Borrower under the Loan Agreement.

Additional Bonds

Additional Bonds may be issued to refund Bonds in whole or in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) or for any other purpose but only if upon the issuance of such Additional Bonds: (A) the amount on deposit in the Senior Liquidity Reserve Account will be at least equal to the Senior Liquidity Reserve Requirement; (B) no Event of Default shall have occurred and be continuing after the date of issuance of the Additional Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Additional Bonds as computed on the basis of new projections on the date of sale of the Additional Bonds will not exceed (x) the remaining weighted average life of each such Turbo Term Bond as computed by the Authority on the basis of new projections assuming that no such Additional Bonds are issued plus (y) one year; and (D) a Rating Confirmation is received for any Bonds that will remain Outstanding after the date of issuance of the Additional Bonds which are then rated by a Rating Agency. In determining compliance with clause (C) of this paragraph, the Authority may rely conclusively on a certificate of a financial advisory or underwriting firm, who may rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption.

Additional Subordinate Bonds

Additional Subordinate Bonds may be issued by the Authority without satisfying the requirements of the Indenture relating to Additional Bonds for any lawful purpose, including to refund all or a portion of the Bonds, if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

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

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 the SPMs to become parties to the MSA. The three OPMs together with the SPMs are referred to as the "**PMs**." Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to NAAG, as of May 5, 2006, 47 PMs have signed the MSA. The chart below identifies each of the PMs which was a party to the MSA as of May 5, 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.
	The Chancellor Tobacco Company, UK Ltd.	P.T. Djarum
	Commonwealth Brands, Inc.	Pacific Stanford Manufacturing
	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 U.S.) to any entity that is not a PM under the MSA, unless the transferee agrees to assume the obligations of the transferring PM under the MSA related to such brands, formulas or businesses. The MSA expressly provides that the payment obligations of each PM are not the obligation or responsibility of any affiliate of such PM and, further, that the remedies, penalties or sanctions that may be imposed or assessed in connection with a breach or violation of the MSA will only apply to the PMs and not against any other person or entity. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "– Subsequent Participating Manufacturers" herein.

Scope of Release

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

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

- monetary claims based on future conduct, acts or omissions in any way relating to the use of or exposure to tobacco products manufactured in the ordinary course of business, including future claims for reimbursement of health care 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 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. All such persons or entities are referred to collectively in the MSA as "**Releasing Parties**."

To the extent that the California Attorney General does not have the power or authority to bind any of the California 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, Annual Payments and Strategic Contribution Fund Payments.* See "Initial Payments," "Annual Payments" and "Strategic Contribution Fund Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustments to Payments" and "Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and the PMs have made the Annual Payments for 2000, 2001, 2002, 2003, 2004, 2005 and 2006 (subject to certain withholdings described in "RISK FACTORS—Other Potential Payment Decreases Under the Terms of the MSA" herein). See "Payments Made to Date" below. Strategic Contribution Fund Payments are scheduled to begin April 15, 2008 and continue through April 15, 2017.

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

Beginning with the payments due in the year 2000, PricewaterhouseCoopers LLP (the "**MSA Auditor**") has, among other things, calculated and determined the amount of all payments owed pursuant to the MSA, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the

---

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

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 2006, the scheduled base amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion, $6.5 billion, $6.5 billion, $8.0 billion, $8.0 billion and 8 billion, respectively. After application of the adjustments, the Annual Payment made (i) in April 2000 was approximately $3.5 billion, (ii) in April 2001 was approximately $4.1 billion, (iii) in April 2002 was approximately $5.2 billion, (iv) in April 2003 was approximately $5.1 billion, (v) in April 2004 was approximately $6.2 billion, (vi) in April 2005 was approximately $6.3 billion, and (vii) in April 2006 was approximately $5.8 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 2006 Annual Payments have been made. However, subsequent adjustments to these Annual Payments may impact subsequent Annual Payments and Strategic Contribution Fund Payments. See SUMMARY OF MASTER SETTLEMENT AGREEMENT - Annual Payments" herein.

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. See "– Subsequent Participating Manufacturers" herein. Each SPM has Annual Payment and Strategic Contribution Fund Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share. However, any SPM that became a party to the MSA within 90 days after it became effective pays only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share.

"**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 "**U.S.**"), 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 2006, as discussed under the caption "Payments Made to Date" herein.

Strategic Contribution Fund Payments

The OPMs are also required to make Strategic Contribution Fund Payments on April 15, 2008 and on April 15 of each year thereafter through 2017. The base amount of each Strategic Contribution Fund Payment is $861 million. The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The SPMs will be required to make Strategic Contribution Fund Payments if their market share increases above the higher of their respective 1998 market share or 125% of their 1997 market share. See "– Subsequent Participating Manufacturers" herein.

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

- the Inflation Adjustment,
- the Volume Adjustment,

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

Adjustments to Payments

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

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

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

If the Actual Volume in a given year is less than the Base Volume, the base amount due from the OPMs (in the case of Annual Payments and Strategic Contribution Fund Payments, after application of the Inflation Adjustment) is decreased by 98% of the percentage by which the Actual Volume is less than the Base Volume, multiplied by such base amount. If, however, the aggregate operating income of the OPMs from sales of cigarettes in the U.S. 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 and divided by four, then added to the payment due. However, in no case will the amount added back due to the increase in operating income exceed the amount deducted due to the decrease in domestic volume. Any add-back due to an increase in Actual Operating Income will be allocated among the OPMs on a Pro Rata basis in accordance with their respective increases in Actual Operating Income over 1997 Base Operating Income.

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

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

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

Non-Participating Manufacturers Adjustment. The NPM Adjustment is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and operates to reduce the payments of the PMs under the MSA in the event that the PMs incur losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM adjustment; (1) the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997, (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, and (3) the Settling States in question must be proven to not have diligently enforced their Qualifying Statutes. The "**NPM Adjustment**" is applied to the subsequent year's Annual Payment and Strategic Contribution Fund Payment and the decrease in total funds available as a result of the NPM Adjustment is then allocated on a Pro Rata basis among those Settling States (i) that have been proven to not diligently enforce their Qualifying Statutes or (ii) that have enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16 ⅔% 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 16 ⅔%, the NPM Adjustment will be calculated as follows:

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share - 16 ⅔%)]
x[market share loss -16 ⅔%]

The MSA further provides that in no event shall the amount of an NPM Adjustment applied to any Settling State in any given year exceed the amount of Annual and Strategic Contribution Fund Payments to be received by such Settling State in such year. The NPM Adjustment applies only to the Annual Payments and Strategic Contribution Fund Payments, and does not apply at all if the number of cigarettes shipped in or to the U.S. 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 U.S. by all such PMs in 1997.

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute (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 (i) that have been proven to not have diligently enforced the Model Statute or Qualifying Statute, or (ii) that have enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment will not exceed 65% of the amount of such state's allocated payment. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts a Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See

"RISK FACTORS – Other Potential Payment Decreases Under the Terms of the MSA" above and "MSA Provisions Relating to Model/Qualifying Statutes" below.

The MSA provides that if any Settling State resolves claims against any NPM that are comparable to any of the claims released in the MSA on overall terms more favorable to such NPM, than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State.

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

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

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

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments and Strategic Contribution Fund Payments which are made at the same times as the Annual Payments and Strategic Contribution Fund Payments to be made by OPMs. Annual Payments and Strategic Contribution Fund Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Fund Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the U.S. 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 and Strategic Contribution Fund Payment, each SPM is required to pay an amount equal to the base amount of the Annual Payment and the Strategic Contribution Fund Payment owed by the OPMs, collectively, adjusted for the Volume Adjustment described above but prior to any other adjustments, reductions or offsets, multiplied by (i) the difference between that SPM's Market Share for the preceding year and its Base Share, divided by (ii) the aggregate Market Share of the OPMs for the preceding year. Other than the application of the Volume Adjustment, payments by the SPMs are also subject to the same adjustments (including the Inflation Adjustment), reductions and offsets as are the payments made by the OPMs, with the exception of the Previously Settled States Reduction.

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first six Annual Payments and the California Escrow Agent has disbursed to the County or the 2001 Indenture Trustee the County's allocable portions thereof and certain other amounts under the MSA totaling $228,610,425.62 to date. These amounts are not pledged to payment of the Series 2006 Bonds. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Fund Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to the County, the Borrower, and the Authority by the State.

MSA Payments Made to Date

Year	Type of Payment	Base Payment	Actual Payment
1999/2000	Upfront and Initial Payment	$23,489,000.00	$22,235,720.64
2001	Initial Payment	12,276,000.00	9,339,615.03
2002	Initial Payment	12,644,000.00	10,939,828.14
2003	Initial Payment	12,889,000.00	10,211,889.88
2000	Annual Payment	21,696,000.00	16,672,805.51
2001	Annual Payment	24,106,000.00	19,840,270.51
2002	Annual Payment	31,015,000.00	26,188,967.68
2003	Annual Payment	31,015,000.00	25,531,833.12
2004	Annual Payment	38,172,000.00	29,994,076.98
2005	Annual Payment	38,172,000.00	30,081,847.61
2006	Annual Payment	38,172,000.00	27,573,570.52[1]

Source: State of California, Office of the Attorney General, Department of Justice.

[1] Reflects withholdings made by PMs in April 2006 with respect to their market share losses for calendar year 2003. See "RISK FACTORS – Other Potential Payment Decreases Under the Terms of the MSA – *NPM Adjustment*" herein.

Both the Settling States and one or more of the PMs are disputing or have disputed the calculations of some of the Initial Payments for the years 2000 through 2003, and some Annual Payments for the years 2000 through 2006. 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

If 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 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, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State. In no event will the adjustments discussed in this paragraph modify the MSA with regard to other Settling States. See "RISK FACTORS – *Disputed or Recalculated Payments and Disputes under the Terms of the MSA*" herein.

Disbursement of Funds from Escrow

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

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts shall occur within 10 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 proof-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

Any Settling State's participation in the MSA is automatically terminated if such Settling State does not reach State Specific Finality on or before December 31, 2001. The State achieved State-Specific Finality on October 28, 1999. The MSA is also terminated as to a Settling State (i) if the MSA or consent decree in that Settling State is disapproved by a court and the time for an appeal has expired, the appeal is dismissed or the disapproval is affirmed or (ii) if the representations and warranties of the attorney general of that state 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 and Strategic Contribution Fund Payments are subject to, among other adjustments and reductions, the NPM Adjustment, which may reduce the amount of money that a Settling State receives pursuant to the MSA. The NPM Adjustment will reduce payments of a PM if such PM experiences certain losses of market share in the U.S. as a result of participation in the MSA.

Settling States may eliminate or mitigate the effect of the NPM Adjustment by taking certain actions, including the adoption 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-á-vis* NPMs within such Settling State as a result of the provisions of the MSA." Exhibit T to the MSA sets forth the model form of Qualifying Statute (the "**Model Statute**") that will qualify as a Qualifying Statute so long as the statute is enacted without modification or addition (except for particularized state procedural or technical requirements) and is not enacted in conjunction with any other legislative or regulatory proposal. The MSA also provides a procedure by which a Settling State may enact a statute that is not the Model Statute and receive a determination from a nationally recognized firm of economic consultants that such statute is a Qualifying Statute. See "RISK FACTORS – Other Potential Payment Decreases under the Terms of the MSA – *NPM Adjustment*" and "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statute and Related Legislation" herein.

If a Settling State continuously has a Qualifying Statute in full force and effect and diligently enforces the provisions of such statute, the MSA states that the payments allocated to such Settling State will not be subject to a reduction due to the NPM Adjustment. Furthermore, the MSA dictates that the aggregate amount of the NPM Adjustment is to be allocated, in a pro rata manner, among all Settling States that do not adopt and diligently enforce a Qualifying Statute. In addition, if the NPM Adjustment allocated to a particular Settling State exceeds its allocated payment, that excess is to be reallocated equally among the remaining Settling States that have not adopted and 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 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 the Model Statute is invalidated or declared unenforceable by a court, or, upon reconsideration by a nationally recognized firm of economic consultants, is determined not to be a Qualifying Statute, the Settling State that adopted such statute will become fully subject to the NPM Adjustment.

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 that does not join the MSA would be subject to the provisions of the Model Statute because

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

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

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

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

than such state's allocable share of the total payments that such NPM would have been required to make if it had been a PM under the MSA (as determined before certain adjustments or offsets); or (iii) 25 years after the date that the funds were placed into escrow (less any amounts paid out pursuant to (i) or (ii)).

In recent years legislation has been enacted in at least 44 of the Settling States, including the State, to amend the Qualifying or Model Statutes in those states by eliminating the reference to the allocable share and limiting the possible release a NPM may obtain under a Model Statute to the excess above the total payment that the NPM would have paid for its cigarettes had it been a PM (each an "**Allocable Share Release Amendment**").

If the NPM fails to place funds into escrow as required, the attorney general of the applicable Settling State may bring a civil action on behalf of the state against the NPM. If a court finds that an NPM violated the statute, it may impose civil penalties as follows: (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 any event, 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 U.S. that do not themselves engage in any activity in the U.S. 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 U.S. may be difficult. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

Status of California Model Statute. The California Model Statute, in the form of the Model Statute attached to the MSA as Exhibit T, has been enacted as Part 3, Chapter 1, Sections 104555 et seq. of the California Health and Safety Code. Counsel for the OPMs has confirmed in writing that the California Model Statute, if maintained and preserved in its current form, would constitute a Model Statute within the meaning of the MSA. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT

There follows a brief description of the California Consent Decree, the MOU, the ARIMOU and the California Escrow Agreement. This description is not complete and is subject to, and qualified in its entirety by reference to, the terms of the MOU, the ARIMOU, the Consent Decree and the California Escrow Agreement, each of which is attached to this Offering Circular as Appendix D.

General Description

On December 9, 1998, the Consent Decree and Final Judgment that governs the class action portion of the State's action against the tobacco companies, was entered in the Superior Court of the State of California for the County of San Diego. The Consent Decree, which is final and non appealable, settled the litigation brought by the State against the OPMs and resulted in the achievement of California State Specific Finality under the MSA. The Consent Decree incorporated by reference the MOU. The Superior Court of the State of California for the County of San Diego entered an order approving the ARIMOU on January 18, 2000.

Prior to the entering of the Consent Decree, the plaintiffs of certain pending lawsuits agreed, among other things, to coordinate their pending cases and to allocate certain portions of the recovery among the State and the Participating Jurisdictions. This agreement was memorialized in the MOU. To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU among the State and the Participating Jurisdictions, the parties entered into the ARIMOU. Upon satisfying certain conditions set

forth in the MOU and the ARIMOU, the Participating Jurisdictions are deemed to be "eligible" to receive a share of the TSRs to which the State is entitled under the MSA. As of the date of this Offering Circular, all of the Participating Jurisdictions under the MOU and ARIMOU, including the County, have satisfied the conditions of the MOU and the ARIMOU and are eligible to receive funds under the MOU and the ARIMOU. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

Under the MOU, 45% of the State's allocation of TSRs under the MSA is allocated to the Participating Jurisdictions that are counties, 5% is allocated to the four Participating Jurisdictions that are cities, and 50% is retained by the State. The 45% share of the TSRs allocated to the Participating Jurisdictions that are counties is allocated among the counties based on population, on a per capita basis as reported in the Official U.S. Decennial Census. The last Official U.S. Decennial Census was in 2000. The allocations made to the Participating Jurisdictions through December 2001 were based upon the 1990 Census data, which entitled the County to receive approximately 3.777% of the total statewide Participating Jurisdictions' share of TSRs. Pursuant to the proportional allocable share provided in the MOU and the ARIMOU (based upon the 2000 Census data), since January 1, 2002, the County has been entitled to receive approximately 3.738% of the total statewide share of the TSRs allocated to Participating Jurisdictions that are counties within the State. This percentage is subject to adjustment for population and other factors as described below. See "– Flow of Funds and California Escrow Agreement" below.

To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU among the State and the Participating Jurisdictions, the parties entered into the ARIMOU.

Flow of Funds and California Escrow Agreement

Under the MSA, the State's portion of the TSRs is deposited into the California State Specific Account held by the MSA Escrow Agent. Pursuant to the terms of the MOU, the ARIMOU and an Escrow Agreement between the State and the California Escrow Agent, the State has instructed the MSA Escrow Agent to transfer (upon receipt thereof) all amounts in the California State Local Agency Escrow Account to the California Escrow Agent. The California Escrow Agent will deposit the State's 50% share of the TSRs in an account for the benefit of the State, and the remaining 50% of the TSRs into separate accounts within the California Local Government Escrow Account for the benefit of the Participating Jurisdictions. The transfer of the TSRs into the California Local Government Escrow Account is not subject to legislative appropriation by the State or any further act by the State, nor are such funds subject to any lien of the State.

Pursuant to the California Escrow Agreement, the California Escrow Agent will distribute to each Participating Jurisdiction (including the County) its allocable proportional share of the TSRs as determined by the MOU and the ARIMOU, within one business day of a deposit into the California Local Government Escrow Account, unless the California Escrow Agent receives different instructions in writing from the State three business days prior to a deposit. The State may make any necessary adjustment to the allocable proportional shares following the issuance of each Official U.S. Decennial Census. See the ARIMOU attached hereto as Appendix D for a list of the Participating Jurisdictions and their proportional allocable share under the ARIMOU.

On July 30, 2001, an order was issued by the Superior Court of the State of California for the County of San Diego amending the ARIMOU (the "**ARIMOU Amendment**"). The order provides that an Eligible City or Eligible County participating in a tobacco securitization may provide that, once the related bonds are issued and so long as the related bonds are outstanding, all amounts of its MOU Proportional Allocable Share may be transferred directly to the indenture trustee for the related bonds, and that so long as such bonds are outstanding, no further transfer instructions may be provided to the State for transmission to the California Escrow Agent unless countersigned by the indenture trustee and, after the related bonds are repaid, unless countersigned by the relevant buyer. The County will execute instructions to provide for transfer of its MOU Proportional Allocable Share directly to the Indenture Trustee pursuant to the ARIMOU Amendment.

All fees and expenses due and owing the California Escrow Agent will be deducted equally from the State Escrow Account and the California Local Government Escrow Account prior to the disbursement of any funds pursuant to the California Escrow Agreement. Such fees are set forth in the California Escrow Agreement and may be adjusted to conform to its then current guidelines. If at any time the California Escrow Agent is served with any judicial or administrative order or consent decree that affects the amounts deposited with the California Escrow Agent, the California Escrow Agent is authorized to comply with such order or consent decree in any manner it or its legal counsel deems appropriate. If any fees, expenses or costs incurred by the California Escrow Agent or its legal counsel are not promptly paid, the Escrow Agent may reimburse itself from TSRs in escrow. The California Escrow Agreement provides that only the State and the California Escrow Agent, and their respective permitted successors, are entitled to its benefits. Pursuant to the Loan Agreement, an event of default will have occurred if the County revokes its instructions under the California Escrow Agreement, which will, in turn, cause an Event of Default under the Indenture.

The California Escrow Agreement also provides a mechanism for the State to escrow TSRs to satisfy "Claims Over" entitling a PM to an offset for amounts paid under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – Offset for Claims Over" herein.

Enforcement Provisions of the Consent Decree, the MOU and the ARIMOU

The MOU provides that the distribution of tobacco-related recoveries is not subject to alteration by legislative, judicial or executive action at any level, and, if such alteration were to occur and survive legal challenge, any modification would be borne proportionally by the State and the Participating Jurisdictions. The Consent Decree specifically incorporates the entire MOU as if it were set forth in full in the Consent Decree. Thus, the allocation of the State's TSRs under the MSA among the State and the Participating Jurisdictions set forth in the MOU is final and non-appealable. However, the MSA provides (and the Consent Decree confirms) that only the State is entitled to enforce the PMs' payment obligations under the MSA, and the State is prohibited expressly from assigning or transferring its enforcement rights. In addition, the State and the Participating Jurisdictions are the only intended beneficiaries of the ARIMOU and the only parties entitled to enforce its terms and those provisions of the MOU incorporated into the ARIMOU.

Release and Dismissal of Claims

The MSA provides that, effective upon the occurrence of State Specific Finality in the State, the State will release and discharge all past, present and future smoking related claims against all Released Parties. In the MOU and the ARIMOU, the Participating Jurisdictions, including the County, agreed that the sharing of the recovery in the State's TSRs was conditioned upon the release by each Participating Jurisdiction of all tobacco related claims consistent with the extent of the State's release and a dismissal with prejudice of any state or county's pending action. The County has taken the necessary action to satisfy this condition.

Potential Payment Adjustments under the MOU and the ARIMOU

The MOU provides that the amount of TSRs payable thereunder are subject to numerous adjustments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" and "RISK FACTORS – Potential Payment Adjustments for Population Changes Under the MOU and the ARIMOU" herein.

CERTAIN INFORMATION RELATING TO THE 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. Although the Authority has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Authority has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the California 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 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2006 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 and Strategic Contribution Fund Payments. The Relative Market Share information reported is confidential under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT-Overview of Payments by the Participating Manufacturers; MSA Escrow Agent –Annual Payments" and "– Strategic Contribution Fund 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 U.S., the District of Columbia and Puerto Rico. The Global Insight Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the U.S., the District of Columbia and Puerto Rico may not match at any given 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 U.S. in the first quarter of 2006 collectively accounted for approximately 86.4% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the U.S. divides generally into premium and discount sales, approximately 71.9% and 28.1%, respectively, measured by volume of all domestic cigarette sales for the three months ending March 31, 2006, as reported by Loews Corporation.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, the Altria Group, Inc. was named Philip Morris Companies Inc. In its Quarterly Report on Form 10-Q filed with the SEC for the three months ended March 31, 2006, Altria reported that Philip Morris' domestic retail market share for the first quarter of 2006 was 50.4% (based on sales), which represents an increase of 0.4 share points from its reported domestic retail market share (based on sales) of 50.0% for the comparable quarter of 2005. 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 U.S., with approximately 40.4% of the U.S. domestic retail share for the first quarter of 2006, up from 39.8% for the first quarter of 2005, 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 U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corp. ("**B&W**"), previously the third largest tobacco company in the U.S.,

under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs.

In its Quarterly Report on Form 10–Q filed with the SEC for the three months ended March 31, 2006, Reynolds American reported that its domestic retail market share for the first quarter of 2006 was 29.95% (measured by sales volume), which represents a decrease of 0.67 share points from the 30.62% on the first quarter of 2005 combined domestic retail market share of Reynolds Tobacco and B&W. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation, is the third largest tobacco company in the U.S. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. In its Quarterly Report on Form 10–Q filed with the SEC for the three months ended March 31, 2006, Loews Corporation reported that Lorillard's domestic retail market share for the first quarter of 2006 was 9.6% (measured by shipment volume), which represents an increase of 0.3 share points from its self-reported 2005 domestic retail market share of 9.3% (measured by shipment volume). Lorillard's principal brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 92.0% of Lorillard's unit sales for the first quarter of 2006. Market share data reported by Lorillard is based on data made available by Management Science Associates, Inc. ("**MSAI**"), an independent third-party database management organization that collects wholesale shipment data.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market in for the three months ended March 31, 2006 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fourth largest tobacco company in the U.S. In its Form 10–Q filed with the SEC for the three months ended March 31, 2006, Vector reported that Liggett's domestic retail market share in 2005 was 2.2% (measured by shipment volume and using MSAI data), which represents a decrease of 0.1 share points from its self-reported 2004 domestic retail market share of 2.3%. All of Liggett's unit volume for the first quarter of 2006 was in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid and USA. In November 2001, Vector Group launched OMNI, which Vector Group claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. Additionally, Vector Group announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Vector has determined to postpone the national launch of QUEST indefinitely. Liggett and Vector Group Ltd. are SPMs under the MSA.

Shipment Trends

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

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

CBI and other low volume companies are higher. All industry volume and market share information herein reflects MSAI's revised reporting data. Despite the effects of MSAI's new estimation model for deep discount manufacturers, Lorillard management has indicated that it continues to believe that volume and market share information for the deep discount manufacturers are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	2003	2004	2005
Philip Morris	46.7%	47.4%	48.7%
Reynolds American**	29.6	28.8	28.2
Lorillard	8.6	8.8	9.2
Other***	15.1	15.0	13.9

* 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.

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

*** The market share based on shipments of the tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in the publicly available documents of Loews Corporation from 100%.

The following table sets forth the industry's cigarette shipments in the U.S. for the three years ended December 31, 2005. The MSA payments are calculated in part on shipments by the OPMs in or to the U.S. rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
2003	401.2
2004	394.5
2005	381.0

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

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

Consumption Trends

According to the April 2006 estimates of the U.S. Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the U.S. consumed 376 billion cigarettes in 2005, which represents a decrease of approximately 3% from the previous year. USDA-ERS attributes declining cigarette use to a combination of higher consumer costs due to tax and price increases, restrictions on where people can smoke and greater awareness of the health risks associated with smoking. Annual per capita consumption (per adult over 18) has dropped from 2,505 cigarettes in 1995 to 1,716 in 2005. The following chart sets forth domestic cigarette consumption from 2001 through 2005:

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

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

** Estimated.

Distribution, Competition and Raw Materials

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

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

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

Grey Market

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

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum

age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charging state employees who smoke higher health insurance premiums than non-smoking state employees. Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc. and Northwest Airlines, are now charging smokers higher premiums. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the U.S. Food and Drug Administration (the "**FDA**"), amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. Philip Morris has indicated its strong support for this legislation. It has been recently reported that various states have requested the Alcohol and Tobacco Tax and Trade Bureau to categorize "little cigars" as another form of cigarettes that require federal regulation. 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 U.S. Cigarette advertising in other media in the U.S. is required to include information with respect to the "tar" and nicotine yield of cigarettes, as well as a warning statement.

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

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

Since the initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports 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 Cal-toxic air MSA.

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

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

In June 2000, the New York state legislature passed legislation charging New York's Office of Fire Prevention and Control ("**OFPC**") with developing standards for "fire-safe" or self-extinguishing cigarettes. On December 31, 2003, OFPC issued a final standard with accompanying regulations that requires all cigarettes offered for sale in New York State after June 28, 2004 to achieve specified test results when placed on 10 layers of filter paper in controlled laboratory conditions. Reynolds American's operating companies that sell cigarettes in New York state have provided written certification to both the OFPC and the Office of the Attorney General for New York that each of their cigarette brand styles currently sold in New York has been tested and has met the performance standards set forth in the OFPC's regulations. Design and manufacturing changes were made for cigarettes manufactured for sale in New York to comply with the standard. 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, the State enacted a similar law that will take effect on January 1, 2007. Similar legislation was also enacted in Illinois in May 2006, which will go into effect in 2008. A number of other states are also considering similar legislation. Varying standards from state to state could have an adverse effect on the PMs.

According to the Global Insight Cigarette 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 sixteen 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 on November 8, 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 went 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. And in January 2006, the District of Columbia enacted an extensive ban which will be fully in effect in January 2007. In 2006, Arkansas, Colorado, Hawaii, Utah, and Puerto Rico enacted similar legislation. It is expected that the restrictions will continue to proliferate. Currently, at least one state, Ohio, is considering a comprehensive ban. The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of April 17, 2006, there were 2,216 municipalities in the U.S. with indoor smoking restrictions. The first extensive outdoor smoking restrictions were instituted on March 17, 2006 in Calabasas, California.

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

Smokeless Tobacco Products. Smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and spit-free. According to the Global Insight Consumption Report, chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of approximately 5% since 2002, with over 5 million consumers. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006 the two largest U.S. cigarette manufacturers entered the market. Philip Morris is introducing a snuff product, Taboka, and Reynolds American has acquired Conway Company, the second largest domestic producer.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where 'snus', a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

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

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on

February 27, 2005 for the first forty countries, including the U.S., that had ratified the treaty prior to November 30, 2004. As of April 27, 2005, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. It has been reported that as of November 3, 2005, 100 countries had ratified the FCTC.

Excise Taxes. Cigarettes are also currently subject to substantial excise taxes in the U.S. The federal excise tax per pack of 20 cigarettes is $0.39 as of February 2006. 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 and $2.00 per pack in Cook County, Illinois, which includes Chicago. According to the Global Insight Cigarette Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. As a result, the current population weighted average state excise tax is $0.913 per pack. In 2006 at least ten states are considering proposed excise tax increases, including increases $1.00 in New York, and up to $2.60 in California. Additional taxes on cigarettes are being proposed through two initiatives for the November 2006 ballot in California. The proposed $2.60 per pack increase on cigarettes in California is an initiative on the State's November 2006 ballot. If the proposed $2.60 increase becomes effective, California would have the nation's highest cigarette tax. In addition, both houses of the Texas legislature have approved bills that would raise the excise tax by $1.00 over a three year period beginning in January 2007. The governor is expected to sign the reconciled version of the legislation.

As mentioned above, at least one state, Minnesota, currently imposes a 75 cents "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover the state's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld in Minnesota (a Previously Settled State) state court as not in violation of Minnesota's settlement with the tobacco companies.

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 "secondary smoke". Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of May 1, 2006, there were 11 cases on appeal in which verdicts were returned against Philip Morris, including (i) a $74 billion (out of total a verdict of $145 billion) punitive damages judgment against Philip Morris in the *Engle* class action, which has been overturned by a Florida district court of appeal and is currently on appeal to the Florida Supreme Court; and (ii) a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. The Supreme Court of Illinois subsequently reversed the verdict in *Price* and instructed the trial court to dismiss the case in its entirety. In January 2006 the plaintiffs filed a motion asking the court to reconsider its decision. On May 5, 2006, the Supreme Court of Illinois denied this motion. 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 May 1, 2006, verdicts have been returned in 44 smoking and health cases, Lights/Ultra Lights cases and healthcare cost recovery cases in which Philip Morris was a defendant. Verdicts in favor of Philip Morris and other tobacco industry defendants were returned in 28 of these cases. Verdicts in favor of plaintiffs were returned in 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, the Carter case (discussed below) was the first to reach final resolution in March 2001, when the plaintiff received payments from a trust in the full amount of the judgment and Brown & Williamson's petition for review of the judgment against it was denied by the U.S. Supreme Court. In addition, five of the 16 cases have reached final resolution with respect to Philip Morris. A $17.8 million verdict against defendants in a healthcare cost recovery case in New York was reversed, and all claims were dismissed with prejudice in February 2005 in the *Blue Cross/Blue Shield* case. In October 2004, after exhausting all appeals, Philip Morris paid $3.3 million in an individual smoking and health case in Florida (the *Eastman* case, discussed below). In March 2005, after exhausting all appeals, Philip Morris paid $17 million in an individual smoking and health case in California (the *Henley* case, discussed below). Altria has reported that in December 2005, after exhausting all appeals, Philip Morris paid $328,759 as its share of the judgment amount and interest in a flight attendant ETS case in Florida (the *French* case, discussed below) and will pay attorneys' fees yet to be determined. In addition, in February 2005, after exhausting all appeals, Reynolds Tobacco, due to its obligation to indemnify B&W, paid approximately $9.1 million in the *Boerner* case (see below) and on June 17, 2005, after exhausting all appeals, Reynolds Tobacco paid a $196,416 plus interest and costs judgment in an individual case in Kansas (the *Burton* case, discussed below). In March 2006, after exhausting all appeals, Philip Morris paid approximately $82.5 million (including interest of approximately $27 million) in an individual smoking and health case in the State (the *Boeken* case, described below).

Class Action Lawsuits. The MSA does not release the PMs from liability in class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking, price fixing and consumer fraud. One OPM has reported that, as of May 1, 2006, there were 35 such class actions pending against it in the U.S., 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 dismissed by the plaintiffs after being decertified by the U.S. 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 U.S. District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases included individual and purported nationwide class action lawsuits alleging tobacco-related personal injuries, as well as healthcare cost recovery cases brought by union trust funds, an insurance plan and an asbestos fund. The suit sought to certify a nationwide class action to consolidate all punitive damage aspects of the pending cases for a single trial and to try the compensatory damage aspects of the pending claims separately. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consisted of all smokers diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease, after April 9, 1993. In May 2005, the U.S. Court of Appeals for the Second Circuit, in a unanimous opinion, decertified the class. Plaintiffs' motion for rehearing en banc was denied on August 8, 2005, and the time for plaintiffs to petition the U.S. Supreme Court for further review has expired. On February 6, 2006, Judge Weinstein dismissed the case upon the plaintiffs' motion. He stayed the order for 30 days to allow potential plaintiffs who expressed interest in the case to receive notices and to protect their interest. On March 22, 2006, a final judgment was entered dismissing the case. Two of the 10 original cases, *Falise v. American Tobacco Co.*, and *H.K. Porter Company, Inc. v. The American Tobacco Company* were dismissed in June 2001 and July 2001, respectively. Other plaintiffs who would have been part of the *Simon II* class remain free to pursue their own individual lawsuits.

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 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. Altria has reported that as of May 1, 2006, approximately 2,626 of these individual

cases (known as *Broin II* cases) are pending against it in Florida. In October 2000, Judge Robert P. Kaye, the presiding judge of the original *Broin I* class action, held that the flight attendants will not be required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages, if any. The court also ruled that the trials of these suits will address whether the plaintiffs' alleged injuries were caused by their exposure to ETS and, if so, the amount of damages. The defendants' appeal of these rulings was dismissed by the intermediate appellate court on the basis that the appeal was premature and that the court lacked jurisdiction. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. That request was denied.

Seven *Broin II* cases have gone to trial since Judge Kaye's ruling in October 2000. Six of these cases have resulted in verdicts for the defendants: *Fontana* in June 2001, Tucker in June 2002, *Janoff* in October 2002, *Seal* in February 2003, *Routh* in October 2003 and *Swaty* in May 2005. Appeals are pending in some of these cases. On September 12, 2002, the plaintiff in the *Janoff* case filed a motion for a new trial, which the judge granted on January 8, 2003. The defendants appealed to the Florida Third District Court of Appeal, which, on October 27, 2004, affirmed the trial court's order granting a new trial. The defendants' motion for rehearing was denied. The defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court on June 17, 2005. On November 1, 2005, the Florida Supreme Court refused to hear the case. In *Swaty*, the plaintiff filed a motion for a new trial on May 12, 2005, which was denied on June 23, 2005. On May 17, 2005, the court entered a final judgment in favor of the defendants. The plaintiff's motion for a new trial was denied on June 23, 2005. The plaintiff 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. On November 28, 2005, the Florida Supreme Court declined to hear the appeal. The defendants satisfied the judgment on December 6, 2005.

In *Scott v. American Tobacco Company, Inc.*, a Louisiana medical monitoring and smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also choose to bring individual smoking and health lawsuits. On July 28, 2003, following the first phase of a trial, the jury returned a verdict in favor of the tobacco industry defendants on the medical monitoring claim and found that cigarettes were not defective products. The jury found against the defendants, however, on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On March 31, 2004, phase two of the trial began to address the scope and cost of smoking cessation programs. On May 21, 2004, the jury returned a verdict in the amount of $591 million ($590 million plus prejudgment interest accruing from the date the suit commenced) on the class's claim for a smoking cessation program. On July 1, 2004, the judge upheld the jury's verdict and awarded the plaintiffs prejudgment interest, which, as of May 1, 2006, totals approximately $400 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. Briefing is complete. Oral argument occurred on April 27, 2006. The defendants filed post-argument briefs on April 28, 2006. Under the terms of the stipulation, the plaintiffs reserved the right to contest the constitutionality of the bond cap law.

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

Altria has reported that approximately 928 cases against Philip Morris and other tobacco industry defendants are pending in a single West Virginia court in a consolidated proceeding. The West Virginia court has scheduled a single trial for these consolidated cases, but it has certified a question to the Supreme Court of Appeals of West Virginia requesting a determination of the extent to which the claims in these individual cases can be consolidated in a single trial. On December 2, 2005, the Supreme Court of Appeals of West Virginia held that the Due Process Clause of the 14th Amendment, as interpreted by *State Farm v. Campbell*, does not preclude a bifurcated trial plan in which a punitive damages multiplier is established prior to compensatory damages.

In *Daniels v. Philip Morris* (also known as *In re Tobacco Case II*), 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 16, 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 May 1, 2006, there were 25 putative class actions pending against Philip Morris in the U.S. on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights, Merit Lights and Cambridge Lights.

These actions allege, among other things, that the use of the terms "Lights" 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 did 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 U.S. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. The plaintiffs filed a motion asking the court to reconsider its decision, which was denied on May 5, 2006 by the Supreme Court of Illinois. It is possible that the plaintiffs will seek further appeals. No assurance can be given that such appeals 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 also remains stayed by order of the trial judge, although the plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which appeal was denied on August 19, 2005. Both cases 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 U.S. District Court for the Eastern District of Missouri. On September 30, 2004, the case was remanded to the Circuit Court for the City of St. Louis. Reynolds Tobacco removed the case once again, and on April 18, 2006, the case was remanded for the second time to the Circuit Court for the City of St. Louis. 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 September 2005, the case was removed to federal court. In February 2006, the federal court denied plaintiffs' motion to remand the case to state court. 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. During the pendency of the appeal, Reynolds Tobacco removed the case to the U.S. District Court for the District of Minnesota. On October 17, 2005, the plaintiff filed a motion to remand. The motion was denied on February 14, 2006. On March 9, 2006, the case was transferred to the U.S. Court of Appeals for the Eighth Circuit. The plaintiffs have appealed the order that granted the transfer and the order that denied their motion to remand. On April 5, 2006, the Eighth Circuit dismissed the plaintiffs' appeal of the order denying remand for lack of jurisdiction.

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.* Philip Morris' motion for appellate review of the trial court's class certification decision is pending. 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. B&W filed a petition to the U.S. Court of Appeals for the Fifth Circuit for permission to appeal on January 9, 2006, which was granted on February 10, 2006. Briefing is underway. Philip Morris also filed a petition to the U.S. Court of Appeals for the Fifth Circuit for permission to appeal the *Sullivan* ruling, which was granted on March 31, 2006. On 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. Similar litigation in Arkansas in the case of *Watson v. Philip Morris*, that was removed from state court to the U.S. Court of Appeals for the Eighth Circuit, was the subject of a writ of certiorari granted by the U.S. Supreme Court, and it has been reported that the U.S. Supreme Court has requested comment from the U.S. Solicitor General as to whether federal jurisdiction of the matter, based on the involvement of the Federal Trade Commission, was appropriate.

In *Schwab v. Philip Morris USA, Inc.*, smokers of "Lights" cigarettes filed a purported class action suit in the U.S. District Court for the Eastern District of New York against the OPMs and their parent companies, Liggett and certain other entities. Plaintiffs allege that the defendants formed an "association-in-fact" enterprise, in violation of the federal RICO statute, to defraud the public into believing that "light" cigarettes were healthier alternatives to regular cigarettes. Plaintiffs seek to certify a nationwide class of smokers comprising all purchasers of "light" cigarettes manufactured by the defendants since the 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. The trial judge has permitted several months of additional discovery before deciding the class certification issue.

On May 23, 2001, a lawsuit was filed in the U.S. 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 U.S. 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 or other health effects have resulted from their use of cigarettes, addiction to smoking, or exposure to environmental tobacco smoke. Individual plaintiffs' allegations of liability are based on various theories of recovery, including but not limited to, negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, restitution, indemnification, violations of deceptive trade practice laws and consumer protection statutes, and claims under federal and state RICO statutes. The tobacco industry has traditionally defended individual health and smoking lawsuits by asserting, among other defenses, assumption of risk and/or comparative fault on the part of the plaintiff, as well as lack of proximate cause.

Altria has reported that as of May 1, 2006, there were approximately 1,133 individual plaintiff smoking and health cases pending in the U.S. 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 2,626 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 U.S. Supreme Court a petition for a writ of certiorari. On March 21, 2005, the U.S. 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 U.S. Supreme Court for further review. In October 2003, the U.S. Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of *State Farm v. Campbell*. In June 2004, the Oregon Court of Appeals reinstated the punitive damages award. In December 2004, the Oregon Supreme Court granted Philip Morris' petition for review of the case. On February 2, 2006, the Oregon Supreme Court affirmed the Court of Appeals decision, holding that the punitive damage award does not violate the due process guarantees of the U.S. Constitution. On March 30, 2006, Philip Morris filed a petition for certiorari review with the U.S. Supreme Court challenging the ruling of the Oregon Supreme Court as a violation of the principles set forth in *State Farm v. Campbell* regarding the permissible size of punitive damage awards relative to compensatory damage awards.

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

- In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the 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.

- In October 2000, a Tampa, Florida jury in *Jones v. R.J. Reynolds Tobacco Co.* found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages; the jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002 the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff has filed for permission to appeal to the Florida Supreme Court. On December 9, 2002, the Supreme Court of Florida issued an order to show cause as to why Jones' notice of appeal should not be treated as a notice to invoke discretionary jurisdiction. On April 27, 2005 the Florida Supreme Court denied the plaintiff's notice of appeal without prejudice. On May 25, 2005 the plaintiff served an amended notice of intent to invoke discretionary jurisdiction. On August 31, 2005, the Florida Supreme Court denied review for lack of jurisdiction. On April 20, 2006, a voluntary dismissal of all claims against Reynolds Tobacco was filed.

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

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

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

- In December 2001, a Florida state court jury awarded the plaintiff $165,000 in compensatory damages but no punitive damages in *Kenyon v. R.J. Reynolds Tobacco Co.* Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which, on May 30, 2003, affirmed per curium (that is, without writing an opinion) the trial court's judgment in favor of the plaintiff. Reynolds Tobacco paid 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 U.S. 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 for appellate work.

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

- In March 2002, a Portland, Oregon jury awarded approximately $168,500 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Incorporated.* The trial judge subsequently reduced the punitive damages awarded to $100 million. Philip Morris and the plaintiffs have each appealed. On May 17, 2006, the appellate court affirmed the $168,500 compensatory damage jury verdict, but overturned the $100 million award of punitive damages because the jury imposed punitive damages (and the court refused to give jury instructions to the contrary) for conduct and harm occurring outside the boundaries of the State of Oregon, a violation of the Due Process Clause. The case was remanded to reconsider the amount of punitive damages.

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

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

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

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

- In November 2003, in *Thompson v. Philip Morris, Inc.*, a Missouri jury returned a split verdict, awarding approximately $1.6 million in compensatory damages to the plaintiff and an additional $500,000 in damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W and the remaining 50% to the plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. 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 and briefing is complete.

- 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. On August 18, 2005, B&W filed a notice of appeal. Pursuant to its agreement to indemnify B&W, on February 7, 2006, Reynolds Tobacco posted a supersedeas bond in the approximate amount of $2.058 million. The jury also returned a punitive damages award totaling $17.1 million against Philip Morris. In December 2005, Philip Morris' post-trial motions challenging the verdict were denied by the trial court. Philip Morris has appealed.

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

Healthcare Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals and others, are seeking reimbursement of healthcare cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. Altria has reported that as of May 1, 2006, there were four healthcare cost recovery actions pending

against Philip Morris in the U.S. In addition, it has been reported that on August 4, 2005, a national senior citizens' organization has filed a lawsuit in Boston against cigarette manufacturers under the federal "Medicare as Secondary Payer" statute, which permits Medicare beneficiaries or others to bring actions on behalf of Medicare to recover healthcare costs paid by Medicare for which another party may be liable. The plaintiffs are reportedly seeking to recover more than $60 billion in alleged Medicare spending on treatment of smoking related illnesses since 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 payor of medical costs (such as an insurer) can seek recovery of healthcare costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual healthcare recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most courts that have decided motions in these cases have dismissed all or most of the claims against the industry. In addition, eight federal 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 U.S. 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 U.S. against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. Such suits have been brought in the U.S. by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. Thirty-four of these suits have been dismissed and two remain pending. In addition to these cases brought in the U.S., healthcare cost recovery actions have also been brought in Israel, the Marshall Islands (where the suit was dismissed), Canada, France 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 U.S. government filed a lawsuit in the U.S. District Court for the District of Columbia against the OPMs, certain related parent companies and two tobacco industry research and lobbying organizations, seeking medical cost recovery for federal funds spent to treat alleged tobacco-related illnesses and asserting violation of RICO. In September 2000, the trial court dismissed the government's medical cost recovery claims, but permitted discovery to proceed on the government's claims for relief under RICO. The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In June 2004, the trial court certified that order for immediate appeal, and in July 2004, the U.S. Court of Appeals for the District of Columbia agreed to hear the appeal on an expedited basis. On February 4, 2005, the appeals court, in a 2-1 decision, ruled that disgorgement is not an available remedy in this case. This ruling eliminated the government's claim for $280 billion and limits the government's potential remedies principally to forward-looking relief, including funding for anti-smoking programs. The government appealed this ruling to seek a rehearing en banc. On April 20, 2005, the appeals court denied the government's appeal. On July 18, 2005, the government appealed the ruling with regard to the $280 billion disgorgement decision to the U.S. Supreme Court. On October 17, 2005 the U.S. Supreme Court, without comment, denied the appeal.

In addition to the claim for disgorgement, the government 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. The defendants filed a motion to dismiss the government's request for the $14 billion award, arguing that the award was barred by the February 4, 2005 appellate decision. On July 22, 2005, the District Court judge granted the motion made under Federal Rule of Civil Procedure 24 by six public interest groups to intervene in this action for the very limited purpose of being heard on the issue of permissible and appropriate remedies in this case, should the government prevail on its claims with respect to smoking cessation programs. On August 15, 2005, the parties filed their proposed findings of fact. Post-trial briefing was completed on October 9, 2005.

In 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 February 15, 2006, there were two cases pending against domestic cigarette manufacturers in Kansas (*Smith v. Philip Morris*) and New Mexico (*Romero v. Philip Morris*), alleging that defendants conspired to fix cigarette prices in violation of antitrust laws. The plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision in the *Romero* case. On April 19, 2005, the defendants filed motions for summary judgment.

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

U.S. v. Pasquantino. On September 13, 2005, the Second Circuit Court of Appeals found that Pasquantino was inapplicable to the case and affirmed its earlier decision that the revenue rule bars foreign sovereigns' civil claims for recovery of lost tax revenue and law enforcement costs related to cigarette smuggling. In January 2006, the U.S. Supreme Court rejected the European Union's petition for review.

- *Patent Litigation.* In 2001 and 2002, Star Scientific, Inc. ("**Star**") filed two patent infringement actions against Reynolds Tobacco in the U.S. District Court for the District of Maryland. Such actions have been consolidated. Reynolds Tobacco filed various motions for summary judgment, which were all denied. Reynolds Tobacco has also filed counterclaims seeking a declaration that the claims of the two Star patents in dispute are invalid, unenforceable and not infringed by Reynolds Tobacco. Between January 31, 2005 and February 8, 2005, the District Court held a first bench trial on Reynolds Tobacco's affirmative defense and counterclaim based upon inequitable conduct. The District Court has not yet issued a ruling on this issue. Additionally, in response to the court's invitation, Reynolds Tobacco filed two summary judgment motions on January 20, 2005. The District Court has indicated that it will rule on Reynolds Tobacco's two pending summary judgment motions and the issue of inequitable conduct at the same time. 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 the Authority's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2006 Bonds are referred to the reports filed with the SEC by certain of the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filing, one OPM states that it is not possible to predict the outcome of litigation pending against it, and that it is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending litigation, and that it is possible that its business, volume, results of operations, cash flows or financial position could be materially affected by an unfavorable outcome or settlement of certain pending litigation or by the enactment of federal or state tobacco legislation. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could adversely affect the business of the PMs and the market for or prices of securities such as the Series 2006 Bonds payable from tobacco settlement payments made under the MSA.

GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT

The following information has been extracted from the Global Insight Cigarette Consumption Report, a copy of which is attached hereto as Appendix A. This summary does not purport to be complete and the Global Insight Cigarette 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 Cigarette Consumption Report forecasts future U.S. domestic cigarette consumption. The MSA payments are based in part on cigarettes shipped in and to the U.S. Cigarette shipments and cigarette consumption may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

General

Global Insight has prepared a report, dated May 26, 2006 (previously defined as the "Global Insight Cigarette Consumption Report") for the Authority on the consumption of cigarettes in the U.S. from 2004 through 2046 entitled, "A Forecast of U. S. Cigarette Consumption (2004-2046) for Tobacco Securitization Authority of Southern California." 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.

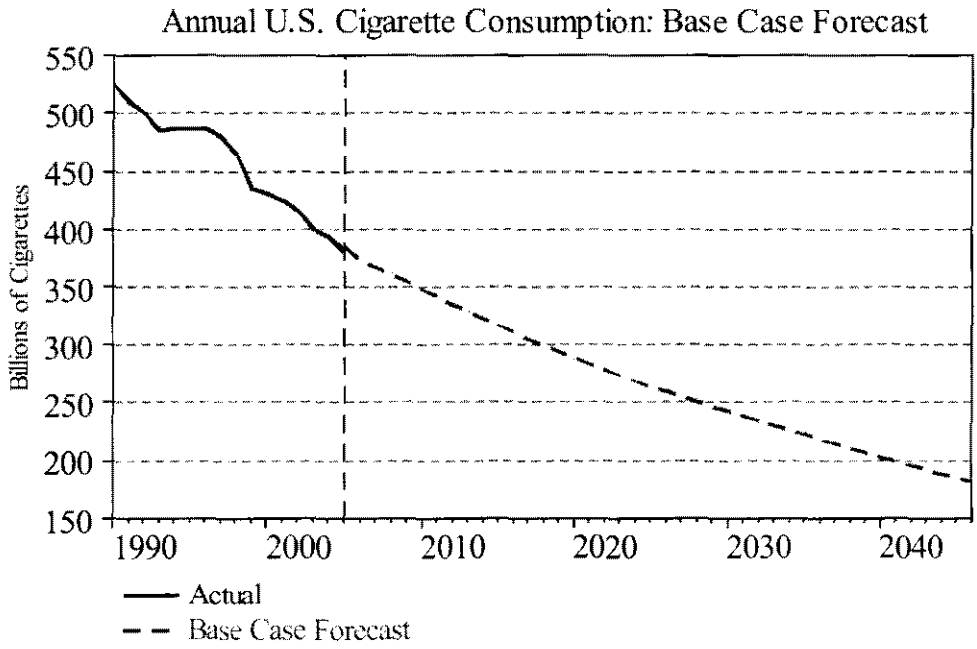
Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2003. Global Insight constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising 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 U.S. 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 U.S. economy, was then used to project total U.S. cigarette consumption from 2004 through 2046 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total U.S. cigarette consumption in 2046 will be 182 billion cigarettes (approximately 9 billion packs), a 54% decline from the 2003 level. From 2004 through 2046, the average annual rate of decline is projected to be 1.81%. On a per capita basis, consumption is forecast to fall during the same period at an average annual rate of 2.53%. Total consumption of cigarettes in the U.S. is forecast to fall from an estimated 381 billion in 2005, to 373 billion in 2006, to under 300 billion by 2018, and under 200 billion by 2041, as set forth in the following table. The Global Insight Cigarette 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	2026	259.36
2005	381.00	2027	254.97
2006	373.34	2028	250.69
2007	366.86	2029	246.48
2008	360.59	2030	242.34
2009	353.96	2031	238.16
2010	347.62	2032	234.12
2011	341.27	2033	230.14
2012	334.93	2034	226.19
2013	328.54	2035	221.88
2014	322.14	2036	217.98
2015	316.45	2037	214.19
2016	310.82	2038	210.53
2017	305.06	2039	206.72
2018	299.41	2040	203.02
2019	293.71	2041	199.44
2020	288.43	2042	195.80
2021	283.17	2043	192.24
2022	278.11	2044	188.76
2023	273.09	2045	185.34
2024	268.43	2046	182.02
2025	263.84		

The following graph displays the projected time trend of cigarette consumption in the U.S



The Global Insight Cigarette Consumption Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2046 total U.S. consumption could be as low as 149 billion or as high as 194 billion cigarettes. In addition, the Global Insight Cigarette Consumption Report presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

Comparison with Prior Forecasts

This forecast differs from those provided in similar studies in 2005 and 2006. In February 2006 full year data on industry shipments for 2005 were reported by the manufacturers and by the Alcohol and Tobacco Tax and Trade Bureau. From this data Global Insight estimates that consumption in 2005 was 381 billion cigarettes, 4 billion fewer than projected. This new data has been incorporated into the revised forecast. Its long term implications are that consumption levels in 2046 are forecast to be 182 billion, 3 billion fewer than the 185 billion in Global Insight's forecasts of 2005.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable U.S. consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other U.S. possessions, and small tax-exempt categories, 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 U.S. domestic cigarette consumption for the eight years ended December 31, 2005. The data in this table vary from statistics on cigarette shipments in the U.S. 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 U.S., 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
2005	381(*est.*)	-3.05%
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, (viii) health warnings, and (ix) smokeless tobacco products. 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 U.S. 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.

GLOBAL INSIGHT POPULATION REPORT

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

General

Global Insight has also prepared A Forecast of Population (2000-2040) for Counties in California including San Diego County, dated May 26, 2006, with respect to the population of California counties from 2000 through 2040. For a description of Global Insight, see "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT – General." See Appendix B – "GLOBAL INSIGHT POPULATION REPORT" attached hereto.

Global Insight's population model was designed to forecast the county-by-county population of California from 2000 to 2040 in order to provide the County population shares used in the determination of the payments made to the County under the ARIMOU. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT – General Description." Global Insight considered the impact of fertility/birth rates, mortality rates/life expectancy, migration (including international, domestic, and intra-county migration with California), race, age, gender and ethnicity, as well as the business cycle, land area and usage, water resources, and environmental risks such as earthquakes. Global

Insight found the following variables to be relevant in building an empirical model of California population through 2040 by county and share of the total population: births, deaths, and migration (international, domestic and county to county). The projections and forecasts are based on assumptions regarding the future paths of these factors, as further described in the Global Insight Population Report that Global Insight believes are reasonable.

Projections and Forecasts

The projections and forecasts included in the Global Insight Population Report, including, but not limited to, those regarding the future population of the County, 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 the Global Insight Population 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, the County's population inevitably will vary from the projections and forecasts included in the Global Insight Population Report and the variations may be material and adverse.

Global Insight projects that the population in the County will increase by 54% in the next 40 years. Global Insight states that among the factors for this growth are geographical location, ethnic diversity, and cost of living considerations.

On March 16, 2006, the Bureau of the Census released the 2005 estimates of the population for counties that indicated that the County's population in 2005 was 2,933,462, which is lower than Global Insight's 2001 forecast. Based on the Bureau of the Census' 2005 estimates, the County's share of State population is 8.12%. This estimate is somewhat lower than DRI•WEFA's 2001 forecast of 8.33%.

Domestic migration, both within the State and between the State and other states, is a volatile demographic component because it substantially depends on relative differences in economic conditions across the State and nation. Domestic in-migration began to wane at the start of this decade. Then, with home prices escalating and affordability declining, net domestic migration turned sharply negative in 2003. However, the magnitude of the net outflow is uncertain. The California Department of Finance estimates the net outflow of residents at 7,200 in 2004, and 12,400 in 2005. The Bureau of the Census meanwhile estimates the net out-migration from San Diego had been 97,500 this decade, with an outflow of 43,100 in 2005. The two sources also result in different estimates of the county's current share of state population. The Bureau of the Census estimates result in a 2005 share of 8.12%, while the Department of Finance estimates result in a share for San Diego of 8.26%.

These preliminary estimates will be revised in 2007 as further data becomes available from the U.S. Internal Revenue Service based on tax returns filed in 2006. For this reason, and given the wide disparity in the migration component, the Global Insight Population Report assumes, for the purpose of generating a forecast, that in 2005 the actual domestic migration is an average of the two sources, or 28,000. Global Insight states that there is no reason a priori to give greater credence to either estimate. This assumption affects Global Insight's forecast in two ways - first in setting the starting point, 2005, in applying the results of Global Insight's economic and demographic change models, and second, in the behavior over time of the domestic out-migration. The economic model predicts a decline in the net outflow, which Global Insight attributes to the extremely high housing prices in the County. The normalization of the migration behavior, to its long run equilibrium, spans a longer time period (into the next decade) if it starts from a level as high as the Census 2005 estimate indicates.

Global Insight projects that the County's share of the total population for the State of California will be as follows:

GLOBAL INSIGHT PROJECTED POPULATION

Year	State Population	County Population	County's Percentage of State Population*
2000	33,871,648	2,813,833	8.31%
2010	38,518,314	3,071,382	7.97
2020	42,869,736	3,469,819	8.09
2030	47,169,112	3,883,651	8.23
2040	51,549,610	4,340,977	8.42

* Rounded to the nearest hundredth of a percent.

Department of Finance Projection

The Global Insight Population Report also includes the California population projections completed by the California Department of Finance ("DOF"). The DOF forecast extending to 2040 revised the County's share of State population for 2040 at 8.32%, 0.1 percentage point lower than Global Insight's projected share of 8.42%.

Comparison with Prior Forecasts

In 2001, Global Insight (then DRI•WEFA) presented a similar study "A Forecast of Population (1999-2040) for Counties in California including San Diego County". In that report Global Insight projected that the County's share of California population would increase to 8.37% in 2010 to 8.59% in 2020, 8.92% in 2030, and to 9.28% in 2040. The current forecast is for somewhat lower shares for the County. The County's share will decline to 7.97% in 2010, and then rise to 8.42% in 2040.

Estimates by the Bureau of the Census indicate that San Diego population in 2005 was 2,933,462, 3.1% lower than that projected in Global Insight's 2001 forecast. In that earlier forecast Global Insight had anticipated that net domestic migration would turn negative by 2015. However, data this decade indicate that net outflows began in 2003. As a result, Global Insight has lowered its migration estimates in its report. For the state, the estimated 2005 population was also somewhat lower than anticipated in 2001, for the similar reason that net outflows to other states accelerated in 2004 and 2005. For this reason Global Insight has also made a small downward adjustment in the state population forecast. The County's share in 2005 was, by the Census estimate, 8.12%, somewhat lower than the 8.33% projected in 2001.

SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION

Introduction

The following discussion describes the methodology and assumptions used to calculate projections of County Tobacco Assets to be received by the Authority (the "Cash Flow Assumptions"), as well as the methodology and assumptions used to structure the Turbo Term Bond Maturities and Sinking Fund Installments for the Series 2006 Bonds and calculate the projected Turbo Redemptions (the "Bond Structuring Methodology"). In addition, sensitivity analyses are provided that evaluate the impact of different consumption levels on Turbo Redemptions. If actual results are different from those assumed, it could have a material effect on the forecast of County Tobacco Assets as well as Turbo Redemptions.

Cash Flow Assumptions

In calculating projections of Collections to be received by the Authority, different assumptions of cigarette consumption in the United States, including the forecast developed by Global Insight described as the Base Case Forecast, were applied to calculate Annual Payments and Strategic Contribution Fund Payments to be made by the PMs pursuant to the MSA. The calculations of 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 Bonds.

In applying consumption forecasts from the Global Insight Cigarette 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 Cigarette 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 and Strategic Contribution Fund Payments

For each projection, the amount of Annual Payments and Strategic Contribution Fund Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments and Strategic Contribution Fund Payments in the order, and in the amounts, set forth in the MSA, as follows:

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments and Strategic Contribution Fund Payments set forth in the MSA. The inflation rate is compounded annually at the greater of 3.0% or the actual Consumer Price Index for All Urban Consumers in the prior year as published by the Bureau of Labor Statistics (released each January). The calculations of Annual Payments and Strategic Contribution Fund Payments assume the minimum Inflation Adjustment Percentage provided in the MSA of 3.0% in every year except 2000, 2004 and 2005 where actual results were 3.400%, 3.256% and 3.416% respectively.

Volume Adjustment. Next, the Annual Payments and Strategic Contribution Fund 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 MASTER SETTLEMENT AGREEMENT — 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 does not apply to Strategic Contribution Fund Payments. The Previously- Settled States Reduction is as follows for each year of the following period:

---

* The aggregate market share information used in the Cash Flow Assumptions may differ materially from the market share information used by the MSA Auditor in calculating adjustments to Initial Payments, Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments."

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 and Strategic Contribution Fund 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. Thus, the Cash Flow Assumptions include an assumption that the State of California will remain a party to the MSA.

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments and Strategic Contribution Fund 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 will enforce a Qualifying Statute that is not held to be unenforceable. For a discussion of the State's Qualifying Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - MSA Provisions Relating to Model Statute/Qualifying Statutes - State's Qualifying Statute" herein. For a description of the opinion of Orrick, Herrington & Sutcliffe LLP Bond Counsel to be delivered to the Authority with respect to the Model Statute, see "LEGAL CONSIDERATIONS - Qualifying 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 and Strategic Contribution Fund 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 required to make Annual Payments and Strategic Contribution Fund Payments in each year.

State Allocation Percentage for California. The amounts of Annual Payments and Strategic Contribution Fund Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously- Settled States Reduction (where applicable) for each year were multiplied by the respective State Allocation Percentages for the State (12.7639554% for Annual Payments and 5.1730408% for Strategic Contribution Fund Payments) in order to determine the amount of Annual Payments and Strategic Contribution Fund Payments to be made by the PMs in each year to be allocated to the California State-Specific Account.

MOU and ARIMOU Allocation Percentage for the County. The amount of Annual Payments and Strategic Contribution Fund Payments in each year to be allocated to the California State-Specific Account, calculated as described in the preceding paragraph, was multiplied by the percentage of such payments that is expected to be allocated to the County (presently approximately 3.738% based on US Census Bureau population data from 2000) pursuant to the MOU and the ARIMOU in order to determine the amount of Annual Payments and Strategic Contribution Fund Payments assumed to be received by the Trustee in each year. The County's share is based upon its percentage of the State's population and is subject to change based upon each Official United States Decennial Census. The Cash Flow Assumptions include an assumption that the County's share of California's TSRs is as presented in the table below, which is based upon the Population Report provided by Global Insight. See Appendix B – "GLOBAL INSIGHT POPULATION REPORT" attached hereto.

Census	County as a % of State	County's Share of California TSRs	County's Share of MSA Annual Payments	County's Share of MSA Strategic Payments
2000	8.31%	3.738%	0.477%	0.193%
2010	7.97%	3.588%	0.458%	0.186%
2020	8.09%	3.642%	0.465%	0.188%
2030	8.23%	3.705%	0.473%	0.192%
2040	8.42%	3.789%	0.484%	0.196%

Interest Earnings

The Cash Flow Assumptions assume that the Trustee will receive ten days after April 15th the County's share of the Annual Payments owed by the PMs in 2007 and each year thereafter. It is further assumed that ten days after April 15th, the Trustee will receive the County's share of the Strategic Contribution Fund Payments in each year from 2008 through 2017. Earnings are assumed at 4.00% per annum on the Payments received by the Trustee until the applicable Distribution Date. Interest earnings have been assumed to begin accruing upon receipt by the Trustee of the Annual Payments and Strategic Contribution Fund Payments.

Amounts on deposit in the Senior Liquidity Reserve Account established under the Indenture are assumed to be invested at the rate of 5.34% per annum based upon the Corporation's actual investment.

Other Assumptions

Sinking Fund Installments. The schedule of Sinking Fund Installments for the Series 2006A Senior Current Interest Bonds is as indicated under the heading "THE SERIES 2006 BONDS - Sinking Fund Installments." herein. There is no schedule of Sinking Fund Installments for the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, or the Series 2006D Third Subordinate CABs.

Turbo Term Bond Maturities. The Series 2006 Turbo Term Bonds mature as set forth on the inside front cover hereof.

Senior Liquidity Reserve Account. The Senior Liquidity Reserve Account Requirement was established for the Senior Series 2006 Bonds at $33,274,125.00 Under the Cash Flow Assumptions, on any Distribution Date where the balance in the Senior Liquidity Reserve Account exceeds the Series 2006 Senior Bond Obligation and interest accrued thereon, the balance in the account will be used to redeem Bonds, and thereafter, the balance in the Senior Liquidity Reserve Account is assumed to be $0.

Operating Expense Assumptions. Annual operating expenses of the Authority have been assumed at the Operating Cap of $200,000 in 2006. In 2007, and 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 it has been assumed that the yield on the Authority's investments will not exceed the yield on the Series 2006 Bonds. Operating Expenses for 2006 are funded from amounts held under the Prior Indenture and transferred to the Operating Account established under the Indenture.

Closing Date. The Series 2006 Bonds are assumed to be issued on May 31, 2006.

Interest Rates and Computation of Interest. The Series 2006 Bonds were assumed to bear interest or accrete at the rates set forth on the inside cover hereof. Computations of interest were 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 or refunding of the Series 2006 Bonds, that no Refunding Bonds or Additional Bonds are issued, that no Event of Default occurs and, 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 in December, and that there is a Mandatory Clean-up Call from balances in the Pledged Accounts. 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.

Series 2006 Bond Structuring Methodology

Cigarette Consumption. The Series 2006 Bonds have been structured utilizing the Global Insight Base Case Forecast. The following tables present the projections of Annual Payments, Strategic Contribution Fund Payments and total payments to be received by the Trustee in each year through 2046, 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 CIGARETTE CONSUMPTION REPORT." herein. See APPENDIX A hereto for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Cigarette Consumption Report.

Projection of Annual Payments to be Received by the Trustee
(in dollars)

Year	Global Insight Base Case Consumption Forecast	OPM Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	Issuer's Allocation	Total OPM Annual Payments to Trustee	SPM Annual Payments to Trustee	Total Annual Payments to Trustee
2007	366,861,230,978	312,198,907,562	8,000,000,000	2,239,993,527	(3,332,265,515)	(860,012,138)	6,047,715,875	0.47715534%	28,856,999	2,159,287	31,016,286
2008	360,592,250,500	306,864,005,176	8,139,000,000	2,591,450,817	(3,613,722,786)	(870,900,740)	6,245,827,292	0.47715534%	29,802,298	2,224,618	32,026,916
2009	353,958,548,815	301,218,725,041	8,139,000,000	2,913,364,342	(3,843,617,262)	(882,161,456)	6,326,585,624	0.47715534%	30,187,641	2,253,382	32,441,023
2010	347,623,207,570	295,827,349,642	8,139,000,000	3,244,935,272	(4,091,332,800)	(892,423,156)	6,400,179,317	0.47715534%	30,538,797	2,279,595	32,818,392
2011	341,269,091,951	290,419,997,250	8,139,000,000	3,586,453,330	(4,344,318,159)	(903,257,234)	6,477,877,937	0.47715534%	30,909,540	2,307,269	33,216,809
2012	334,929,406,672	285,024,925,078	8,139,000,000	3,938,216,930	(4,609,197,993)	(913,889,527)	6,554,129,410	0.45799752%	30,017,750	2,240,701	32,258,451
2013	328,543,528,729	279,590,542,948	8,139,000,000	4,300,533,438	(4,885,745,998)	(924,385,341)	6,629,402,099	0.45799752%	30,362,497	2,266,435	32,628,932
2014	322,136,994,313	274,138,582,160	8,139,000,000	4,673,719,441	(5,175,776,316)	(934,561,415)	6,702,381,710	0.45799752%	30,696,742	2,291,385	32,988,127
2015	316,449,072,302	269,298,160,529	8,139,000,000	5,058,101,024	(5,479,289,249)	(944,457,615)	6,773,354,160	0.45799752%	31,021,794	2,315,648	33,337,443
2016	310,818,572,122	264,506,604,875	8,139,000,000	5,454,014,055	(5,779,228,081)	(956,202,338)	6,857,583,636	0.45799752%	31,407,563	2,344,444	33,752,008
2017	305,058,219,080	259,604,544,437	8,139,000,000	5,861,804,477	(6,090,822,293)	(967,974,230)	6,942,007,954	0.45799752%	31,794,225	2,373,307	34,167,532
2018	299,406,730,342	254,795,127,521	9,000,000,000	6,946,364,111	(7,098,261,083)	(979,190,071)	7,868,912,957	0.45799752%	36,039,427	2,654,780	38,694,207
2019	293,712,626,318	249,949,444,997	9,000,000,000	7,424,755,034	(7,473,960,199)	(990,554,631)	7,960,240,204	0.45799752%	36,457,703	2,685,592	39,143,295
2020	288,433,887,303	245,457,238,095	9,000,000,000	7,917,497,685	(7,867,076,878)	(1,001,579,906)	8,048,840,902	0.45799752%	36,863,492	2,715,484	39,578,976
2021	283,166,892,135	240,975,025,207	9,000,000,000	8,425,022,616	(8,264,363,867)	(1,013,779,571)	8,146,879,177	0.45799752%	37,312,505	2,748,560	40,061,064
2022	278,108,962,559	236,670,727,138	9,000,000,000	8,947,773,294	(8,678,038,148)	(1,025,850,693)	8,243,884,454	0.46489580%	38,325,473	2,823,178	41,148,651
2023	273,088,988,991	232,398,729,632	9,000,000,000	9,486,206,493	(9,102,318,652)	(1,038,483,591)	8,345,404,250	0.46489580%	38,797,434	2,857,944	41,655,378
2024	268,432,396,802	228,435,969,679	9,000,000,000	10,040,792,688	(9,542,978,602)	(1,051,091,429)	8,446,722,658	0.46489580%	39,268,459	2,892,641	42,161,101
2025	263,840,890,183	224,528,597,546	9,000,000,000	10,612,016,469	(9,989,390,736)	(1,064,903,918)	8,557,721,815	0.46489580%	39,784,490	2,930,654	42,715,144
2026	259,355,239,128	220,711,308,498	9,000,000,000	11,200,376,963	(10,451,693,727)	(1,078,854,281)	8,669,828,955	0.46489580%	40,305,671	2,969,046	43,274,717
2027	254,972,660,003	216,981,733,663	9,000,000,000	11,806,388,272	(10,928,882,794)	(1,093,110,609)	8,784,394,868	0.46489580%	40,838,283	3,008,280	43,846,563
2028	250,690,537,728	213,337,647,607	9,000,000,000	12,430,579,920	(11,421,423,775)	(1,107,679,950)	8,901,476,195	0.46489580%	41,382,589	3,048,375	44,430,964
2029	246,481,176,364	209,755,481,085	9,000,000,000	13,073,497,317	(11,929,793,336)	(1,122,569,911)	9,021,134,071	0.46489580%	41,938,874	3,089,353	45,028,227
2030	242,335,477,591	206,227,491,430	9,000,000,000	13,735,702,237	(12,455,485,313)	(1,137,677,343)	9,142,539,581	0.46489580%	42,503,283	3,130,929	45,634,212
2031	238,162,154,355	202,675,993,356	9,000,000,000	14,417,773,304	(12,999,368,074)	(1,152,970,182)	9,265,435,048	0.46489580%	43,074,619	3,173,015	46,247,634
2032	234,118,269,099	199,234,647,004	9,000,000,000	15,120,306,503	(13,565,842,123)	(1,168,027,395)	9,386,436,985	0.47291412%	44,389,786	3,269,895	47,659,681
2033	230,143,876,193	195,852,438,640	9,000,000,000	15,843,915,698	(14,148,966,932)	(1,183,574,334)	9,511,374,432	0.47291412%	44,980,633	3,313,419	48,294,051
2034	226,191,454,076	192,488,927,419	9,000,000,000	16,589,233,169	(14,751,752,110)	(1,199,347,907)	9,638,133,151	0.47291412%	45,580,093	3,357,577	48,937,669
2035	221,879,771,769	188,819,685,775	9,000,000,000	17,356,910,164	(15,376,955,009)	(1,215,115,041)	9,764,840,115	0.47291412%	46,179,308	3,401,717	49,581,025
2036	217,980,877,344	185,501,726,619	9,000,000,000	18,147,617,469	(16,043,493,794)	(1,228,856,357)	9,875,267,318	0.47291412%	46,701,534	3,440,186	50,141,719
2037	214,189,741,500	182,275,470,016	9,000,000,000	18,962,045,993	(16,715,948,069)	(1,244,568,174)	10,001,529,750	0.47291412%	47,298,646	3,484,171	50,782,817
2038	210,528,500,720	179,159,754,113	9,000,000,000	19,800,907,373	(17,408,868,930)	(1,260,718,925)	10,131,319,518	0.47291412%	47,912,441	3,529,385	51,441,826
2039	206,721,286,892	175,919,815,145	9,000,000,000	20,664,934,594	(18,121,564,548)	(1,277,466,289)	10,265,903,757	0.47291412%	48,548,908	3,576,269	52,125,178
2040	203,023,794,708	172,773,249,296	9,000,000,000	21,554,882,632	(18,869,174,088)	(1,293,218,416)	10,392,490,128	0.47291412%	49,147,553	3,620,367	52,767,921
2041	199,440,290,532	169,723,687,243	9,000,000,000	22,471,529,111	(19,639,276,368)	(1,309,435,974)	10,522,816,769	0.47291412%	49,763,886	3,665,768	53,429,655
2042	195,795,300,038	166,621,800,332	9,000,000,000	23,415,674,984	(20,432,123,991)	(1,326,179,647)	10,657,371,346	0.48368371%	51,547,969	3,797,190	55,345,159
2043	192,236,299,892	163,593,091,208	9,000,000,000	24,388,145,234	(21,258,466,551)	(1,342,351,112)	10,787,327,571	0.48368371%	52,176,546	3,843,493	56,020,039
2044	188,756,822,864	160,632,056,257	9,000,000,000	25,389,789,591	(22,110,815,836)	(1,358,873,100)	10,920,100,656	0.48368371%	52,818,748	3,890,799	56,709,547
2045	185,342,462,206	157,726,435,337	9,000,000,000	26,421,483,279	(22,990,234,641)	(1,375,724,853)	11,055,523,784	0.48368371%	53,473,767	3,939,050	57,412,818
2046	182,017,591,749	154,896,970,579	9,000,000,000	27,484,127,777	(23,898,353,440)	(1,392,825,697)	11,192,948,639	0.48368371%	54,138,469	3,988,014	58,126,483

Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Trustee
(in dollars)

			Strategic Contribution Fund Payments							Total Payments			
Year	Global Insight Base Case Consumption Forecast	OPM Adjusted Consumption	Base Strategic Payments	Inflation Adjustment	Volume Adjustment	Subtotal	Issuer's Allocation	OPM Strategic Payments to Trustee	SPM Strategic Payments to Trustee	Total Annual Payments to Trustee	Total Strategic Payments to Trustee	Escrow Agent Fee	Total Payments to Trustee
2007	366,861,230,978	312,198,907,562	-	-	-	-	-	-	-	31,016,286	-	(1,346)	31,014,940
2008	360,592,250,500	306,864,005,176	861,000,000	274,141,682	(382,284,718)	752,856,965	0.1933839%	1,455,904	95,378	32,026,916	1,551,282	(1,346)	33,576,853
2009	353,958,548,815	301,218,725,041	861,000,000	308,195,933	(406,604,554)	762,591,379	0.1933839%	1,474,729	96,611	32,441,023	1,571,341	(1,346)	34,011,018
2010	347,623,207,570	295,827,349,642	861,000,000	343,271,811	(432,809,625)	771,462,186	0.1933839%	1,491,884	97,735	32,818,392	1,589,619	(1,346)	34,406,665
2011	341,269,091,951	290,419,997,250	861,000,000	379,399,965	(459,572,175)	780,827,790	0.1933839%	1,509,996	98,922	33,216,809	1,608,917	(1,346)	34,824,381
2012	334,929,406,672	285,024,925,078	861,000,000	416,611,964	(487,593,006)	790,018,959	0.1856196%	1,466,430	96,068	32,258,451	1,562,497	(1,346)	33,819,603
2013	328,543,528,729	279,590,542,948	861,000,000	454,940,323	(516,848,176)	799,092,147	0.1856196%	1,483,271	97,171	32,628,932	1,580,442	(1,346)	34,208,029
2014	322,136,994,313	274,138,582,160	861,000,000	494,418,533	(547,529,599)	807,888,934	0.1856196%	1,499,600	98,241	32,988,127	1,597,840	(1,346)	34,584,622
2015	316,449,072,302	269,298,160,529	861,000,000	535,081,089	(579,637,307)	816,443,782	0.1856196%	1,515,479	99,281	33,337,443	1,614,760	(1,346)	34,950,857
2016	310,818,572,122	264,506,604,875	861,000,000	576,963,521	(611,366,922)	826,596,600	0.1856196%	1,534,325	100,515	33,752,008	1,634,840	(1,346)	35,385,502
2017	305,058,219,080	259,604,544,437	861,000,000	620,102,427	(644,329,524)	836,772,903	0.1856196%	1,553,214	101,753	34,167,532	1,654,967	(1,346)	35,821,153
2018	299,406,730,342	254,795,127,521	-	-	-	-	-	-	-	38,694,207	-	(1,346)	38,692,861
2019	293,712,626,318	249,949,444,997	-	-	-	-	-	-	-	39,143,295	-	(1,346)	39,141,949
2020	288,433,887,303	245,457,238,095	-	-	-	-	-	-	-	39,578,976	-	(1,346)	39,577,630
2021	283,166,892,135	240,975,025,207	-	-	-	-	-	-	-	40,061,064	-	(1,346)	40,059,719
2022	278,108,962,559	236,670,727,138	-	-	-	-	-	-	-	41,148,651	-	(1,346)	41,147,305
2023	273,088,988,991	232,398,729,632	-	-	-	-	-	-	-	41,655,378	-	(1,346)	41,654,033
2024	268,432,396,802	228,435,969,679	-	-	-	-	-	-	-	42,161,101	-	(1,346)	42,159,755
2025	263,840,890,183	224,528,597,546	-	-	-	-	-	-	-	42,715,144	-	(1,346)	42,713,798
2026	259,355,239,128	220,711,308,498	-	-	-	-	-	-	-	43,274,717	-	(1,346)	43,273,371
2027	254,972,660,003	216,981,733,663	-	-	-	-	-	-	-	43,846,563	-	(1,346)	43,845,217
2028	250,690,537,728	213,337,647,607	-	-	-	-	-	-	-	44,430,964	-	(1,346)	44,429,619
2029	246,481,176,364	209,755,481,085	-	-	-	-	-	-	-	45,028,227	-	(1,346)	45,026,881
2030	242,335,477,591	206,227,491,430	-	-	-	-	-	-	-	45,634,212	-	(1,346)	45,632,866
2031	238,162,154,355	202,675,993,356	-	-	-	-	-	-	-	46,247,634	-	(1,346)	46,246,288
2032	234,118,269,099	199,234,647,004	-	-	-	-	-	-	-	47,659,681	-	(1,346)	47,658,335
2033	230,143,876,193	195,852,438,640	-	-	-	-	-	-	-	48,294,051	-	(1,346)	48,292,706
2034	226,191,454,076	192,488,927,419	-	-	-	-	-	-	-	48,937,669	-	(1,346)	48,936,324
2035	221,879,771,769	188,819,685,775	-	-	-	-	-	-	-	49,581,025	-	(1,346)	49,579,679
2036	217,980,877,344	185,501,726,619	-	-	-	-	-	-	-	50,141,719	-	(1,346)	50,140,373
2037	214,189,741,500	182,275,470,016	-	-	-	-	-	-	-	50,782,817	-	(1,346)	50,781,472
2038	210,528,500,720	179,159,754,113	-	-	-	-	-	-	-	51,441,826	-	(1,346)	51,440,480
2039	206,721,286,892	175,919,815,145	-	-	-	-	-	-	-	52,125,178	-	(1,346)	52,123,832
2040	203,023,794,708	172,773,249,296	-	-	-	-	-	-	-	52,767,921	-	(1,346)	52,766,575
2041	199,440,290,532	169,723,687,243	-	-	-	-	-	-	-	53,429,655	-	(1,346)	53,428,309
2042	195,795,300,038	166,621,800,332	-	-	-	-	-	-	-	55,345,159	-	(1,346)	55,343,813
2043	192,236,299,892	163,593,091,208	-	-	-	-	-	-	-	56,020,039	-	(1,346)	56,018,693
2044	188,756,822,864	160,632,056,257	-	-	-	-	-	-	-	56,709,547	-	(1,346)	56,708,201
2045	185,342,462,206	157,726,435,337	-	-	-	-	-	-	-	57,412,818	-	(1,346)	57,411,472
2046	182,017,591,749	154,896,970,579	-	-	-	-	-	-	-	58,126,483	-	(1,346)	58,125,138

Series 2006 Senior Bonds' Debt Service Coverage

The following table shows estimated debt service for the Series 2006 Senior Bonds and the resulting estimated debt service coverage ratios, assuming cigarette consumption is consistent with the Global Insight Base Case Forecast, Collections are received in accordance with the Cash Flow Assumptions, no Turbo Redemptions are made in advance of the Sinking Fund Installments and interest rates for the Series 2006 Senior Bonds are as described above under "Bond Structuring Assumptions." As used herein, "debt service **coverage ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period (including earnings on the Senior Liquidity Reserve Account and earnings on TSRs until the applicable Distribution Date) and the denominator of which is the sum 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, and Sinking Fund Installments are based on the assumption that no Turbo Redemptions will occur. Based on the Global Insight Base Case Forecast, the average debt service coverage ratio is 1.42x with a minimum debt service coverage ratio in 2007 through 2019 of 1.23x.

Series 2006 Senior Bonds' Estimated Debt Service Coverage
(in dollars)

Revenue Year	Total Available Funds [1]	Sinking Fund Installments	Interest	Operating Expenses [2]	Total Debt Service and Operating Expenses [3]	Debt Service Coverage for Series Bonds
2007	$33,158,490	$0 -	$26,746,238	$206,000	$26,952,238	1.23
2008	35,727,738	2,140,000	26,695,413	212,180	29,047,593	1.23
2009	36,162,086	2,600,000	26,582,838	218,545	29,401,383	1.23
2010	36,557,565	3,045,000	26,448,769	225,102	29,718,871	1.23
2011	36,974,977	3,535,000	26,292,494	231,855	30,059,349	1.23
2012	35,965,583	2,860,000	26,140,613	238,810	29,239,423	1.23
2013	36,353,706	3,315,000	25,993,956	245,975	29,554,931	1.23
2014	36,729,751	3,785,000	25,825,331	253,354	29,863,685	1.23
2015	37,095,166	4,265,000	25,634,144	260,955	30,160,098	1.23
2016	37,528,953	4,825,000	25,418,256	268,783	30,512,040	1.23
2017	37,963,467	5,410,000	25,175,175	276,847	30,862,022	1.23
2018	40,840,751	8,065,000	24,855,144	285,152	33,205,296	1.23
2019	41,287,175	8,820,000	24,454,125	293,707	33,567,832	1.23
2020	41,716,803	8,730,000	24,037,313	302,518	33,069,830	1.26
2021	42,194,663	9,155,000	23,612,544	311,593	33,079,137	1.28
2022	43,277,829	9,605,000	23,166,994	320,941	33,092,935	1.31
2023	43,779,895	10,070,000	22,699,713	330,570	33,100,282	1.32
2024	44,280,738	10,560,000	22,209,750	340,487	33,110,237	1.34
2025	44,829,669	11,075,000	21,695,919	350,701	33,121,620	1.35
2026	45,383,574	11,625,000	21,142,263	361,222	33,128,485	1.37
2027	45,949,490	12,225,000	20,546,013	372,059	33,143,071	1.39
2028	46,527,634	12,850,000	19,919,138	383,221	33,152,358	1.40
2029	47,118,330	13,510,000	19,260,138	394,717	33,164,855	1.42
2030	47,717,398	14,200,000	18,567,388	406,559	33,173,946	1.44
2031	48,323,567	14,930,000	17,839,138	418,756	33,187,893	1.46
2032	49,727,978	15,695,000	17,073,513	431,318	33,199,831	1.50
2033	50,354,324	16,500,000	16,268,638	444,258	33,212,895	1.52
2034	50,989,502	17,345,000	15,422,513	457,586	33,225,098	1.53
2035	51,623,991	18,235,000	14,533,013	471,313	33,239,326	1.55
2036	52,175,362	19,170,000	13,597,888	485,452	33,253,340	1.57
2037	52,806,666	20,155,000	12,614,763	500,016	33,269,779	1.59
2038	53,455,114	21,205,000	11,567,509	515,017	33,287,526	1.61
2039	54,127,339	22,320,000	10,452,181	530,467	33,302,648	1.63
2040	54,758,357	23,490,000	9,278,300	546,381	33,314,681	1.64
2041	55,407,764	24,725,000	8,042,791	562,772	33,330,563	1.66
2042	57,310,309	26,030,000	6,742,194	579,656	33,351,849	1.72
2043	57,971,517	27,395,000	5,373,178	597,045	33,365,223	1.74
2044	58,646,665	28,840,000	3,932,156	614,957	33,387,113	1.76
2045	59,334,796	30,355,000	2,415,284	633,405	33,403,690	1.78
2046	59,144,109	31,950,000	818,719	652,408	33,421,126	1.77

(1) Includes total payments to the Trustee plus earnings on the Senior Liquidity Reserve Account and other Accounts (except the Rebate Account and the Operating Account) until distributed.

(2) Includes Operating Expenses at the Operating Cap.

(3) Includes interest, Sinking Fund Installments, Turbo Term Bond Maturities 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 Operating Expenses, interest when due, Turbo Term Bond Maturities and Sinking Fund Installments. The above table does not reflect the actual amortization of Series 2006 Senior Bonds that will occur if the Global Insight Base Case Forecast is realized. If actual Collections are received in the amounts assumed based on the Global Insight Base Case Forecast and the Cash Flow Assumptions, Collections would be applied to make Turbo Redemptions as required pursuant to the Indenture. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS—Effect of Changes in Consumption Level on Turbo Redemptions" below.

Effect of Changes in Cigarette Consumption Levels on Turbo Redemptions

Weighted Average Lives and Final Principal Payments. The tables on the following pages 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 Bonds. The tables are based on the Cash Flow Assumptions and the Bond Structuring Methodology, except that the annual cigarette consumption varies in each case. In addition to the Global Insight Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of Global Insight (the Global Insight High Forecast, the Global Insight Low Case 1, the Global Insight Low Case 2 and the Global Insight Low Case 3, each as hereinafter defined) and four other consumption scenarios prepared by Global Insight (assuming 2.5%, 3.0%, 3.5% and 4.0% annual consumption declines). In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the final principal payments and weighted average lives (in years) of each of the Series 2006 Bonds will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast. To the degree actual consumption varies from the alternative scenarios presented below, the weighted average lives (and final projected principal payment dates) for the Series 2006 Bonds will be either shorter (sooner) or longer (later) than projected on the following pages.

Projected Outstanding Bond Obligation for Series 2006 A Senior Current Interest Bonds*
Maturing June 1, 2025
(in dollars)

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	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
May 31, 2006	$111,860,000	$111,860,000	$111,860,000	$111,860,000	$111,860,000	$111,860,000	$111,860,000	$111,860,000	$111,860,000
June 1, 2007	105,485,000	105,430,000	105,555,000	105,635,000	105,485,000	105,640,000	105,795,000	105,955,000	106,110,000
June 1, 2008	96,175,000	96,005,000	96,410,000	96,675,000	100,520,000	96,765,000	97,265,000	97,770,000	98,265,000
June 1, 2009	85,975,000	85,645,000	86,485,000	87,040,000	96,745,000	87,295,000	88,330,000	89,360,000	90,375,000
June 1, 2010	74,885,000	74,335,000	75,780,000	76,750,000	92,455,000	77,205,000	78,965,000	80,715,000	82,435,000
June 1, 2011	62,840,000	62,000,000	64,225,000	65,725,000	87,610,000	66,460,000	69,155,000	71,820,000	74,440,000
June 1, 2012	51,255,000	50,065,000	53,220,000	55,345,000	83,385,000	56,425,000	60,230,000	63,980,000	67,655,000
June 1, 2013	38,720,000	37,105,000	41,375,000	44,245,000	78,630,000	45,745,000	50,875,000	55,920,000	60,845,000
June 1, 2014	25,200,000	23,085,000	28,665,000	32,400,000	73,330,000	34,385,000	41,070,000	47,625,000	54,005,000
June 1, 2015	10,660,000	7,960,000	15,070,000	19,815,000	67,470,000	22,310,000	30,795,000	39,085,000	47,130,000
June 1, 2016	-	-	455,000	6,335,000	60,965,000	9,485,000	20,025,000	30,285,000	40,215,000
June 1, 2017	-	-	-	-	53,780,000	-	8,735,000	21,210,000	33,250,000
June 1, 2018	-	-	-	-	43,825,000	-	-	9,770,000	24,280,000
June 1, 2019	-	-	-	-	33,015,000	-	-	-	15,170,000
June 1, 2020	-	-	-	-	21,320,000	-	-	-	5,910,000
June 1, 2021	-	-	-	-	8,655,000	-	-	-	-
June 1, 2022	-	-	-	-	-	-	-	-	-
June 1, 2023	-	-	-	-	-	-	-	-	-
June 1, 2024	-	-	-	-	-	-	-	-	-
June 1, 2025	-	-	-	-	-	-	-	-	-
Final Maturity:	1-Jun-2016	1-Jun-2016	1-Jun-2017	1-Jun-2017	1-Jun-2022	1-Jun-2017	1-Jun-2018	1-Jun-2019	1-Jun-2021
Average Life:	5.9	5.8	6.1	6.3	10.0	6.4	6.8	7.4	8.2

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

Projected Outstanding Bond Obligation for Series 2006 A Senior Current Interest Bonds*
Maturing June 1, 2037
(in dollars)

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	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
May 31, 2006	$186,440,000	$186,440,000	$186,440,000	$186,440,000	$186,440,000	$186,440,000	$186,440,000	$186,440,000	$186,440,000
June 1, 2007	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2008	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2009	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2010	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2011	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2012	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2013	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2014	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2015	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2016	181,415,000	178,040,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000	186,440,000
June 1, 2017	164,510,000	160,355,000	171,200,000	178,370,000	186,440,000	182,310,000	186,440,000	186,440,000	186,440,000
June 1, 2018	143,800,000	138,715,000	151,915,000	160,610,000	186,440,000	165,505,000	181,130,000	186,440,000	186,440,000
June 1, 2019	121,585,000	115,450,000	131,290,000	141,680,000	186,440,000	147,665,000	166,380,000	184,375,000	186,440,000
June 1, 2020	97,800,000	90,495,000	109,270,000	121,540,000	186,440,000	128,735,000	150,875,000	172,100,000	186,440,000
June 1, 2021	72,325,000	63,715,000	85,730,000	100,055,000	186,440,000	108,655,000	134,580,000	159,355,000	182,925,000
June 1, 2022	44,445,000	34,380,000	60,000,000	76,605,000	180,900,000	86,800,000	116,925,000	145,625,000	172,865,000
June 1, 2023	14,640,000	2,960,000	32,535,000	51,625,000	165,570,000	63,640,000	98,365,000	131,350,000	162,575,000
June 1, 2024	-	-	3,260,000	25,065,000	149,035,000	39,110,000	78,850,000	116,495,000	152,035,000
June 1, 2025	-	-	-	-	131,195,000	13,135,000	58,335,000	101,030,000	141,230,000
June 1, 2026	-	-	-	-	111,985,000	-	36,765,000	84,920,000	130,145,000
June 1, 2027	-	-	-	-	91,320,000	-	14,085,000	68,130,000	118,755,000
June 1, 2028	-	-	-	-	69,115,000	-	-	50,625,000	107,045,000
June 1, 2029	-	-	-	-	45,280,000	-	-	32,365,000	94,995,000
June 1, 2030	-	-	-	-	19,730,000	-	-	13,310,000	82,580,000
June 1, 2031	-	-	-	-	-	-	-	-	69,775,000
June 1, 2032	-	-	-	-	-	-	-	-	56,080,000
June 1, 2033	-	-	-	-	-	-	-	-	41,925,000
June 1, 2034	-	-	-	-	-	-	-	-	27,285,000
June 1, 2035	-	-	-	-	-	-	-	-	12,125,000
June 1, 2036	-	-	-	-	-	-	-	-	-
June 1, 2037	-	-	-	-	-	-	-	-	-
Final Maturity:	1-Jun-2024	1-Jun-2024	1-Jun-2025	1-Jun-2025	1-Jun-2031	1-Jun-2026	1-Jun-2028	1-Jun-2031	1-Jun-2036
Average Life:	14.5	14.2	15.0	15.6	21.2	16.0	17.6	19.8	23.3

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

Projected Outstanding Bond Obligation for Series 2006A Senior Current Interest Bonds Maturing June 1, 2046*
(in dollars)

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	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
May 31, 2006	$236,310,000	$236,310,000	$236,310,000	$236,310,000	$236,310,000	$236,310,000	$236,310,000	$236,310,000	$236,310,000
June 1, 2007	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2008	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2009	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2010	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2011	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2012	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2013	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2014	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2015	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2016	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2017	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2018	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2019	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2020	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2021	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2022	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2023	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2024	219,110,000	205,645,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2025	185,060,000	169,625,000	208,320,000	233,080,000	236,310,000	236,310,000	236,310,000	236,310,000	236,310,000
June 1, 2026	148,675,000	131,080,000	174,970,000	202,945,000	236,310,000	221,940,000	236,310,000	236,310,000	236,310,000
June 1, 2027	109,815,000	89,860,000	139,395,000	170,845,000	236,310,000	192,810,000	236,310,000	236,310,000	236,310,000
June 1, 2028	68,345,000	45,815,000	101,470,000	136,670,000	236,310,000	161,960,000	226,545,000	236,310,000	236,310,000
June 1, 2029	-	-	61,060,000	100,300,000	236,310,000	129,300,000	201,445,000	236,310,000	236,310,000
June 1, 2030	-	-	-	61,615,000	236,310,000	94,730,000	175,020,000	236,310,000	236,310,000
June 1, 2031	-	-	-	-	228,670,000	58,150,000	147,200,000	229,725,000	236,310,000
June 1, 2032	-	-	-	-	198,695,000	-	117,295,000	208,385,000	236,310,000
June 1, 2033	-	-	-	-	166,630,000	-	85,810,000	186,060,000	236,310,000
June 1, 2034	-	-	-	-	132,355,000	-	52,665,000	162,695,000	236,310,000
June 1, 2035	-	-	-	-	95,755,000	-	-	138,235,000	236,310,000
June 1, 2036	-	-	-	-	56,780,000	-	-	112,620,000	232,725,000
June 1, 2037	-	-	-	-	-	-	-	85,785,000	216,425,000
June 1, 2038	-	-	-	-	-	-	-	57,665,000	199,485,000
June 1, 2039	-	-	-	-	-	-	-	-	181,870,000
June 1, 2040	-	-	-	-	-	-	-	-	163,540,000
June 1, 2041	-	-	-	-	-	-	-	-	144,455,000
June 1, 2042	-	-	-	-	-	-	-	-	123,970,000
June 1, 2043	-	-	-	-	-	-	-	-	102,610,000
June 1, 2044	-	-	-	-	-	-	-	-	80,325,000
June 1, 2045	-	-	-	-	-	-	-	-	57,060,000
June 1, 2046	-	-	-	-	-	-	-	-	-
Final Maturity:	1-Jun-2029	1-Jun-2029	1-Jun-2030	1-Jun-2031	1-Jun-2037	1-Jun-2032	1-Jun-2035	1-Jun-2039	1-Jun-2046
Average Life:	21.1	20.7	21.9	22.8	28.7	23.6	26.3	30.0	36.4

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

Projected Outstanding Bond Obligation for Series 2006B First Subordinate CABs Maturing June 1, 2046*
(in dollars)

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	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline**
May 31, 2006	$19,769,610	$19,769,610	$19,769,610	$19,769,610	$19,769,610	$19,769,610	$19,769,610	$19,769,610	$19,769,610
June 1, 2007	21,028,064	21,028,064	21,028,064	21,028,064	21,028,064	21,028,064	21,028,064	21,028,064	21,028,064
June 1, 2008	22,362,804	22,362,804	22,362,804	22,362,804	22,362,804	22,362,804	22,362,804	22,362,804	22,362,804
June 1, 2009	23,782,266	23,782,266	23,782,266	23,782,266	23,782,266	23,782,266	23,782,266	23,782,266	23,782,266
June 1, 2010	25,291,826	25,291,826	25,291,826	25,291,826	25,291,826	25,291,826	25,291,826	25,291,826	25,291,826
June 1, 2011	26,897,205	26,897,205	26,897,205	26,897,205	26,897,205	26,897,205	26,897,205	26,897,205	26,897,205
June 1, 2012	28,604,484	28,604,484	28,604,484	28,604,484	28,604,484	28,604,484	28,604,484	28,604,484	28,604,484
June 1, 2013	30,420,131	30,420,131	30,420,131	30,420,131	30,420,131	30,420,131	30,420,131	30,420,131	30,420,131
June 1, 2014	32,351,025	32,351,025	32,351,025	32,351,025	32,351,025	32,351,025	32,351,025	32,351,025	32,351,025
June 1, 2015	34,404,481	34,404,481	34,404,481	34,404,481	34,404,481	34,404,481	34,404,481	34,404,481	34,404,481
June 1, 2016	36,588,279	36,588,279	36,588,279	36,588,279	36,588,279	36,588,279	36,588,279	36,588,279	36,588,279
June 1, 2017	38,910,691	38,910,691	38,910,691	38,910,691	38,910,691	38,910,691	38,910,691	38,910,691	38,910,691
June 1, 2018	41,380,516	41,380,516	41,380,516	41,380,516	41,380,516	41,380,516	41,380,516	41,380,516	41,380,516
June 1, 2019	44,007,112	44,007,112	44,007,112	44,007,112	44,007,112	44,007,112	44,007,112	44,007,112	44,007,112
June 1, 2020	46,800,429	46,800,429	46,800,429	46,800,429	46,800,429	46,800,429	46,800,429	46,800,429	46,800,429
June 1, 2021	49,771,049	49,771,049	49,771,049	49,771,049	49,771,049	49,771,049	49,771,049	49,771,049	49,771,049
June 1, 2022	52,930,228	52,930,228	52,930,228	52,930,228	52,930,228	52,930,228	52,930,228	52,930,228	52,930,228
June 1, 2023	56,289,932	56,289,932	56,289,932	56,289,932	56,289,932	56,289,932	56,289,932	56,289,932	56,289,932
June 1, 2024	59,862,891	59,862,891	59,862,891	59,862,891	59,862,891	59,862,891	59,862,891	59,862,891	59,862,891
June 1, 2025	63,662,641	63,662,641	63,662,641	63,662,641	63,662,641	63,662,641	63,662,641	63,662,641	63,662,641
June 1, 2026	67,703,578	67,703,578	67,703,578	67,703,578	67,703,578	67,703,578	67,703,578	67,703,578	67,703,578
June 1, 2027	72,001,009	72,001,009	72,001,009	72,001,009	72,001,009	72,001,009	72,001,009	72,001,009	72,001,009
June 1, 2028	76,571,216	76,571,216	76,571,216	76,571,216	76,571,216	76,571,216	76,571,216	76,571,216	76,571,216
June 1, 2029	72,551,597	47,862,787	81,431,514	81,431,514	81,431,514	81,431,514	81,431,514	81,431,514	81,431,514
June 1, 2030	31,749,541	3,818,187	71,790,255	86,600,316	86,600,316	86,600,316	86,600,316	86,600,316	86,600,316
June 1, 2031	-	-	32,582,912	79,714,730	92,097,203	92,097,203	92,097,203	92,097,203	92,097,203
June 1, 2032	-	-	-	42,228,664	97,943,000	83,843,328	97,943,000	97,943,000	97,943,000
June 1, 2033	-	-	-	1,934,667	104,159,855	49,377,655	104,159,855	104,159,855	104,159,855
June 1, 2034	-	-	-	-	110,771,320	12,508,677	110,771,320	110,771,320	110,771,320
June 1, 2035	-	-	-	-	117,802,443	-	102,736,322	117,802,443	117,802,443
June 1, 2036	-	-	-	-	125,279,860	-	74,314,533	125,279,860	125,279,860
June 1, 2037	-	-	-	-	115,700,172	-	44,059,142	133,231,901	133,231,901
June 1, 2038	-	-	-	-	80,903,757	-	11,851,958	141,688,691	141,688,691
June 1, 2039	-	-	-	-	43,339,499	-	-	145,777,893	150,682,269
June 1, 2040	-	-	-	-	2,865,043	-	-	125,252,577	160,246,708
June 1, 2041	-	-	-	-	-	-	-	103,524,500	170,418,242
June 1, 2042	-	-	-	-	-	-	-	79,827,375	181,235,406
June 1, 2043	-	-	-	-	-	-	-	54,721,831	192,739,181
June 1, 2044	-	-	-	-	-	-	-	28,115,272	204,973,149
June 1, 2045	-	-	-	-	-	-	-	-	217,983,659
June 1, 2046									231,371,041
Final Maturity:	1-Jun-2031	1-Jun-2031	1-Jun-2032	1-Jun-2034	1-Jun-2041	1-Jun-2035	1-Jun-2039	1-Jun-2045	NA**
Average Life:	24.3	23.6	25.2	26.3	32.8	27.5	30.9	36.2	NA**

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

** In the event of an Annual Consumption Decline of 3.55% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006B First Subordinate CABs would be repaid by their Turbo Term Bond Maturity Date. In the event of an Annual Consumption Decline of 4.0% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006B First Subordinate CABs may never be paid..

Projected Outstanding Bond Obligation for Series 2006C Second Subordinate CABs Maturing June 1, 2046*
(in dollars)

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	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline	3.5% Annual Consumption Decline**	4.0% Annual Consumption Decline**
May 31, 2006	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657	$ 8,685,657
June 1, 2007	9,252,035	9,252,035	9,252,035	9,252,035	9,252,035	9,252,035	9,252,035	9,252,035	9,252,035
June 1, 2008	9,853,621	9,853,621	9,853,621	9,853,621	9,853,621	9,853,621	9,853,621	9,853,621	9,853,621
June 1, 2009	10,494,324	10,494,324	10,494,324	10,494,324	10,494,324	10,494,324	10,494,324	10,494,324	10,494,324
June 1, 2010	11,176,686	11,176,686	11,176,686	11,176,686	11,176,686	11,176,686	11,176,686	11,176,686	11,176,686
June 1, 2011	11,903,418	11,903,418	11,903,418	11,903,418	11,903,418	11,903,418	11,903,418	11,903,418	11,903,418
June 1, 2012	12,677,402	12,677,402	12,677,402	12,677,402	12,677,402	12,677,402	12,677,402	12,677,402	12,677,402
June 1, 2013	13,501,713	13,501,713	13,501,713	13,501,713	13,501,713	13,501,713	13,501,713	13,501,713	13,501,713
June 1, 2014	14,379,622	14,379,622	14,379,622	14,379,622	14,379,622	14,379,622	14,379,622	14,379,622	14,379,622
June 1, 2015	15,314,614	15,314,614	15,314,614	15,314,614	15,314,614	15,314,614	15,314,614	15,314,614	15,314,614
June 1, 2016	16,310,402	16,310,402	16,310,402	16,310,402	16,310,402	16,310,402	16,310,402	16,310,402	16,310,402
June 1, 2017	17,370,938	17,370,938	17,370,938	17,370,938	17,370,938	17,370,938	17,370,938	17,370,938	17,370,938
June 1, 2018	18,500,432	18,500,432	18,500,432	18,500,432	18,500,432	18,500,432	18,500,432	18,500,432	18,500,432
June 1, 2019	19,703,368	19,703,368	19,703,368	19,703,368	19,703,368	19,703,368	19,703,368	19,703,368	19,703,368
June 1, 2020	20,984,521	20,984,521	20,984,521	20,984,521	20,984,521	20,984,521	20,984,521	20,984,521	20,984,521
June 1, 2021	22,348,978	22,348,978	22,348,978	22,348,978	22,348,978	22,348,978	22,348,978	22,348,978	22,348,978
June 1, 2022	23,802,154	23,802,154	23,802,154	23,802,154	23,802,154	23,802,154	23,802,154	23,802,154	23,802,154
June 1, 2023	25,349,819	25,349,819	25,349,819	25,349,819	25,349,819	25,349,819	25,349,819	25,349,819	25,349,819
June 1, 2024	26,998,116	26,998,116	26,998,116	26,998,116	26,998,116	26,998,116	26,998,116	26,998,116	26,998,116
June 1, 2025	28,753,589	28,753,589	28,753,589	28,753,589	28,753,589	28,753,589	28,753,589	28,753,589	28,753,589
June 1, 2026	30,623,206	30,623,206	30,623,206	30,623,206	30,623,206	30,623,206	30,623,206	30,623,206	30,623,206
June 1, 2027	32,614,390	32,614,390	32,614,390	32,614,390	32,614,390	32,614,390	32,614,390	32,614,390	32,614,390
June 1, 2028	34,735,044	34,735,044	34,735,044	34,735,044	34,735,044	34,735,044	34,735,044	34,735,044	34,735,044
June 1, 2029	36,993,588	36,993,588	36,993,588	36,993,588	36,993,588	36,993,588	36,993,588	36,993,588	36,993,588
June 1, 2030	39,398,987	39,398,987	39,398,987	39,398,987	39,398,987	39,398,987	39,398,987	39,398,987	39,398,987
June 1, 2031	29,714,765	-	41,960,790	41,960,790	41,960,790	41,960,790	41,960,790	41,960,790	41,960,790
June 1, 2032	-	-	34,303,937	44,689,167	44,689,167	44,689,167	44,689,167	44,689,167	44,689,167
June 1, 2033	-	-	-	47,594,948	47,594,948	47,594,948	47,594,948	47,594,948	47,594,948
June 1, 2034	-	-	-	9,338,983	50,689,669	50,689,669	50,689,669	50,689,669	50,689,669
June 1, 2035	-	-	-	-	53,985,615	27,067,148	53,985,615	53,985,615	53,985,615
June 1, 2036	-	-	-	-	57,495,870	-	57,495,870	57,495,870	57,495,870
June 1, 2037	-	-	-	-	61,234,370	-	61,234,370	61,234,370	61,234,370
June 1, 2038	-	-	-	-	65,215,954	-	65,215,954	65,215,954	65,215,954
June 1, 2039	-	-	-	-	69,456,429	-	47,023,666	69,456,429	69,456,429
June 1, 2040	-	-	-	-	73,972,628	-	15,009,102	73,972,628	73,972,628
June 1, 2041	-	-	-	-	38,062,610	-	-	78,782,480	78,782,480
June 1, 2042	-	-	-	-	-	-	-	83,905,079	83,905,079
June 1, 2043	-	-	-	-	-	-	-	89,360,759	89,360,759
June 1, 2044	-	-	-	-	-	-	-	95,171,179	95,171,179
June 1, 2045	-	-	-	-	-	-	-	101,268,564	101,359,404
June 1, 2046	-	-	-	-	-	-	-	77,948,502	107,950,000
Final Maturity:	1-Jun-2032	1-Jun-2031	1-Jun-2033	1-Jun-2035	1-Jun-2042	1-Jun-2036	1-Jun-2041	NA**	NA**
Average Life:	25.7	25.0	26.8	28.2	35.5	29.5	33.9	NA**	NA**

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

** In the event of an Annual Consumption Decline of 3.36% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006C Second Subordinate CABs would be repaid by their Turbo Term Bond Maturity Date. In the event of an Annual Consumption Decline of 3.5% or 4.0% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006C Second Subordinate CABs may never be paid.

Projected Outstanding Bond Obligation for Series 2006D Third Subordinate CABs Maturing June 1, 2046*
(in dollars)

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**	2.5% Annual Consumption Decline	3.0% Annual Consumption Decline**	3.5% Annual Consumption Decline**	4.0% Annual Consumption Decline**
May 31, 2006	20,565,394	20,565,394	20,565,394	20,565,394	20,565,394	20,565,394	20,565,394	20,565,394	20,565,394
June 1, 2007	22,055,667	22,055,667	22,055,667	22,055,667	22,055,667	22,055,667	22,055,667	22,055,667	22,055,667
June 1, 2008	23,649,348	23,649,348	23,649,348	23,649,348	23,649,348	23,649,348	23,649,348	23,649,348	23,649,348
June 1, 2009	25,358,185	25,358,185	25,358,185	25,358,185	25,358,185	25,358,185	25,358,185	25,358,185	25,358,185
June 1, 2010	27,190,498	27,190,498	27,190,498	27,190,498	27,190,498	27,190,498	27,190,498	27,190,498	27,190,498
June 1, 2011	29,155,209	29,155,209	29,155,209	29,155,209	29,155,209	29,155,209	29,155,209	29,155,209	29,155,209
June 1, 2012	31,261,884	31,261,884	31,261,884	31,261,884	31,261,884	31,261,884	31,261,884	31,261,884	31,261,884
June 1, 2013	33,520,782	33,520,782	33,520,782	33,520,782	33,520,782	33,520,782	33,520,782	33,520,782	33,520,782
June 1, 2014	35,942,902	35,942,902	35,942,902	35,942,902	35,942,902	35,942,902	35,942,902	35,942,902	35,942,902
June 1, 2015	38,540,037	38,540,037	38,540,037	38,540,037	38,540,037	38,540,037	38,540,037	38,540,037	38,540,037
June 1, 2016	41,324,835	41,324,835	41,324,835	41,324,835	41,324,835	41,324,835	41,324,835	41,324,835	41,324,835
June 1, 2017	44,310,854	44,310,854	44,310,854	44,310,854	44,310,854	44,310,854	44,310,854	44,310,854	44,310,854
June 1, 2018	47,512,634	47,512,634	47,512,634	47,512,634	47,512,634	47,512,634	47,512,634	47,512,634	47,512,634
June 1, 2019	50,945,767	50,945,767	50,945,767	50,945,767	50,945,767	50,945,767	50,945,767	50,945,767	50,945,767
June 1, 2020	54,626,968	54,626,968	54,626,968	54,626,968	54,626,968	54,626,968	54,626,968	54,626,968	54,626,968
June 1, 2021	58,574,162	58,574,162	58,574,162	58,574,162	58,574,162	58,574,162	58,574,162	58,574,162	58,574,162
June 1, 2022	62,806,571	62,806,571	62,806,571	62,806,571	62,806,571	62,806,571	62,806,571	62,806,571	62,806,571
June 1, 2023	67,344,801	67,344,801	67,344,801	67,344,801	67,344,801	67,344,801	67,344,801	67,344,801	67,344,801
June 1, 2024	72,210,951	72,210,951	72,210,951	72,210,951	72,210,951	72,210,951	72,210,951	72,210,951	72,210,951
June 1, 2025	77,428,716	77,428,716	77,428,716	77,428,716	77,428,716	77,428,716	77,428,716	77,428,716	77,428,716
June 1, 2026	83,023,503	83,023,503	83,023,503	83,023,503	83,023,503	83,023,503	83,023,503	83,023,503	83,023,503
June 1, 2027	89,022,553	89,022,553	89,022,553	89,022,553	89,022,553	89,022,553	89,022,553	89,022,553	89,022,553
June 1, 2028	95,455,078	95,455,078	95,455,078	95,455,078	95,455,078	95,455,078	95,455,078	95,455,078	95,455,078
June 1, 2029	102,352,400	102,352,400	102,352,400	102,352,400	102,352,400	102,352,400	102,352,400	102,352,400	102,352,400
June 1, 2030	109,748,103	109,748,103	109,748,103	109,748,103	109,748,103	109,748,103	109,748,103	109,748,103	109,748,103
June 1, 2031	117,678,200	115,921,769	117,678,200	117,678,200	117,678,200	117,678,200	117,678,200	117,678,200	117,678,200
June 1, 2032	110,412,258	74,985,293	126,181,303	126,181,303	126,181,303	126,181,303	126,181,303	126,181,303	126,181,303
June 1, 2033	70,350,503	30,364,833	126,269,677	135,298,818	135,298,818	135,298,818	135,298,818	135,298,818	135,298,818
June 1, 2034	26,761,184	-	89,295,773	145,075,139	145,075,139	145,075,139	145,075,139	145,075,139	145,075,139
June 1, 2035	-	-	49,118,137	121,661,269	155,557,870	155,557,870	155,557,870	155,557,870	155,557,870
June 1, 2036	-	-	5,622,291	86,324,522	166,798,054	155,183,742	166,798,054	166,798,054	166,798,054
June 1, 2037	-	-	-	48,008,140	178,850,423	125,732,755	178,850,423	178,850,423	178,850,423
June 1, 2038	-	-	-	6,501,484	191,773,664	93,928,532	191,773,664	191,773,664	191,773,664
June 1, 2039	-	-	-	-	205,630,702	59,598,507	205,630,702	205,630,702	205,630,702
June 1, 2040	-	-	-	-	220,489,012	22,557,587	220,489,012	220,489,012	220,489,012
June 1, 2041	-	-	-	-	236,420,942	-	217,296,736	236,420,942	236,420,942
June 1, 2042	-	-	-	-	248,693,175	-	197,035,942	253,504,070	253,504,070
June 1, 2043	-	-	-	-	220,762,202	-	175,268,617	271,821,578	271,821,578
June 1, 2044	-	-	-	-	190,248,601	-	151,883,697	291,462,659	291,462,659
June 1, 2045	-	-	-	-	156,954,504	-	126,762,022	312,522,950	312,522,950
June 1, 2046	-	-	-	-	120,658,761	-	99,775,759	335,105,000	335,105,000
Final Maturity:	1-Jun-2035	1-Jun-2034	1-Jun-2037	1-Jun-2039	NA**	1-Jun-2041	NA**	NA**	NA**
Average Life:	27.6	26.8	28.9	30.6	NA**	32.5	NA**	NA**	NA**

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

** In the event of an Annual Consumption Decline of 2.85% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006D Third Subordinate CABs would be repaid by their Turbo Term Bond Maturity Date. In the event of an Annual Consumption Decline consistent with Global Insight Low Case 3, or an annual consumption decline of 3.0%, 3.5% or 4.0% and taking into account the Cash Flow Assumptions outlined herein, the Series 2006D Third Subordinate CABs may never be paid.

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 Appendix A - "GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT" attached 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, Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.81% to 1.67%, resulting in consumption of 194 billion in 2046.

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 estimates 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 used 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 1.81%, to 1.99%, resulting in cigarette consumption of 169 billion in 2046.

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 2.16% to 157 billion in 2046. 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 occurs in 2006, 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 increases from an average annual rate in the Base Case Forecast of 1.81%, to 2.27%, resulting in cigarette consumption of 149 billion in 2046.

Average Annual Rate of Cigarette Consumption Decline (2004-2046)

Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3
1.81%	1.67%	1.99%	2.16%	2.27%

Finally, for comparative purposes Global Insight calculated the volume of total cigarette consumption under four alternative annual rates of decline, 2.5%, 3.0%, 3.5% and 4.0%. Under these scenarios, Global Insight states that at 2.5%, 3.0%, 3.5% and 4.0% per year, consumption in 2046 falls to 135 billion, 109 billion, 88 billion and 71 billion, respectively. Global Insight advised that these calculations are simple arithmetic examples, and are neither forecasts nor projections.

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

THE AUTHORITY

General

The Authority is a public entity created by a Joint Exercise of Powers Agreement, dated as of September 19, 2001 (as amended and restated, the "**Joint Powers Agreement**"), by and between the County and the County of Sacramento, California (each previously defined as a "Local Agency"), pursuant to Articles 1, 2, 3 and 4 of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California. The Authority was created for the purpose of empowering the Authority to finance the payments to be received by the County under the MOU, the ARIMOU or from any other source (the "**Tobacco Payment Streams**") (including, but not limited to, the issuance, sale, execution and delivery of bonds secured by such Tobacco Payment Streams or the lending of money based on the security thereof) or to securitize, sell, purchase or otherwise dispose of some or all of the Tobacco Payment Streams of the County, and to provide for the exercise of additional powers given to a joint powers entity under the Act, including, but not limited to, the Marks-Roos Local Bond Pooling Act of 1985.

The Authority is a separate entity from the Local Agencies and its debts, liabilities and obligations do not constitute debts, liabilities or obligations of the Local Agencies.

Governing Board

The Authority is administered by the Board of Directors, whose members are, at all times, designees of the governing body of each Local Agency. The Governing Body of the County designated two members of the Board of Directors and the Governing Body of Sacramento designated one member of the Board of Directors. For this purpose, the term "**Governing Body**," will mean the Board of Supervisors, in the case of a Local Agency which is a county. The County and Sacramento County are the only members of the Authority. The Governing Body of each Local Agency may designate an alternate representative. Each representative of the Board of Directors of the Authority has one vote. The alternate representative may vote at meetings of the Board of Directors in the absence of the Local Agency's representative. Representatives and alternate representatives serve at the pleasure of the Local Agency which has appointed them.

Officers

The officers of the Authority are the Chair, Vice-Chair, Secretary and Treasurer/Controller. The Chair is one of the members of the Board of Directors designated as such by the Governing Body of the County and serves until his/her successor is selected. The Clerk of the Board of Supervisors of the County is the Secretary and the Chief Financial Officer of the County is the Treasurer/Controller. The Vice-Chair was selected by the Board of Directors.

THE BORROWER

The Borrower is organized under California law as a nonprofit public benefit corporation. The Borrower is governed by a three-person board of directors consisting of two directors who are employees of the County and one independent director who, for the five-year period prior to his or her election as an independent director, is not an employee of the County; a creditor, customer or supplier of the County or; an immediate family member of a person described in the previous clauses. The Borrower has no assets other than the County Tobacco Assets. The Borrower was organized for the special purpose of purchasing the County Tobacco Assets.

CONTINUING DISCLOSURE

Pursuant to the Indenture, the Authority has agreed to provide, or cause to be provided by no later than 210 days after the end of the prior fiscal year (commencing with the report for the fiscal year ended June 30, 2006), to each Repository certain annual financial information and operating data, including: (1)(a) its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (b) an update of the information set forth herein under the heading "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" under (i) the last three columns in the table captioned "Projection of Initial Payments," (ii) the last four columns in the table captioned "Projection of Annual Payments," (iii) the last four columns in the table captioned "Projection of Strategic Contribution Fund Payments and Total Payments" herein, and (c) the debt service coverage ratio for the most recent Fiscal Year for all Series of Outstanding Bonds determined in the manner described in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION - Series 2006 Senior Bonds' Debt Service Coverage"; and (2) in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any State information depository, notice of any of the following events with respect to the Series 2006 Bonds, if material: (i) principal payments and interest payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the Bonds; (vii) modifications to rights of Bondholders; (viii) bond calls; (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Bonds; (xi) rating changes; and (xii) failure to comply with clause the Continuing Disclosure Provisions of the Indenture. These covenants have been made in order to assist the Underwriters in complying with Rule 15c2-12.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP ("**Bond Counsel**"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 2006 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (previously defined as the "Code") and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the Series 2006 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in Appendix E hereto.

To the extent the issue price of any maturity of the Series 2006 Bonds is less than the amount to be paid at maturity of such Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Bonds) the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Series 2006 Bonds which is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Series 2006 Bonds is the first price at which a substantial amount of such maturity of the Series 2006 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series 2006 Bonds accrues daily over the term to maturity of such Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Bondholders of the Series 2006 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of purchasers who do not purchase such Bonds in the original offering to the public at the first price at which a substantial amount of such Bonds is sold to the public.

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 Bonds. The Authority, the Borrower and the County have made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series 2006 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 Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the Series 2006 Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of issuance of the Series 2006 Bonds may adversely affect the value of, or the tax status of interest on, the Series 2006 Bonds.

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

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

Future legislation, if enacted into law, or clarification of the Code may cause interest on the Series 2006 Bonds to be subject, directly or indirectly, to federal income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislation or clarification of the Code may also affect the market price for, or marketability of, the Series 2006 Bonds. Prospective purchasers of the Series 2006 Bonds should consult their own tax advisers regarding any pending or proposed federal tax legislation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the Series 2006 Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, or the Borrower or the County, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority, the Borrower and the County have covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the Series 2006 Bonds ends with the issuance of the Series 2006 Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority, the Borrower, the County or the beneficial owners regarding the tax–exempt status of the Series 2006 Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority, the Borrower, the County, and their appointed counsels, including the beneficial owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax–exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority, the Borrower or the County legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Series 2006 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 Bonds, and may cause the Authority, the Borrower, the County or the beneficial owners to incur significant expense.

LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2006 Bonds or questioning the creation, organization or existence of the Authority or the Borrower, the validity or enforceability of the Indenture, the Loan Agreement, or the Purchase and Sale Agreement, the sale of the County Tobacco Assets by the County to the Borrower, the proceedings for the authorization, execution, authentication and delivery of the Series 2006 Bonds or the validity of the Series 2006 Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "RISK FACTORS," "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and "LEGAL CONSIDERATIONS" herein.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2006 Bonds, Grant Thornton LLP, independent certified public accountants, (the "**Verification Agent**"), will deliver a report stating that the firm has verified (a) the mathematical accuracy of certain computations relating to the adequacy of the government obligations scheduled to mature in such amounts and at such times and bear interest at such rates as to provide amounts sufficient to pay the principal and the interest due on the 2001 Bonds through the date fixed for redemption, and (b) the computations of actuarial yields of the Series 2006 Bonds and of the government obligations and other investments in the Escrow Fund for the 2001 Bonds.

The report of the Verification Agent will include the statement that the scope of its engagement was limited to verifying the mathematical accuracy of the computations contained in such schedules provided to them and that they have no obligations to update its report because of events occurring, or date or information coming to their attention, subsequent to the date of its report.

RATINGS

It is a condition to the obligation of the Underwriters to purchase the Series 2006 Senior Bonds that they be assigned ratings of "Baa3" by Moody's and "BBB" by S&P (collectively, the "**Rating Agencies**"). It is a condition to the obligation of the Underwriters to purchase the Series 2006B First Subordinate CABs, the Series 2006C Second Subordinate CABs, and the Series 2006D Third Subordinate CABs that they be assigned ratings of "BBB", "BBB-" and "BB" by S&P, respectively.

The rated Series 2006 Bonds were structured to produce cash flow stress test performance necessary for the rated Series 2006 Bonds to achieve the targeted credit ratings. The ratings address each Rating Agency's assessment of (i) the payment of interest on the Senior 2006 Bonds when due and (ii) the payment of principal and Accreted Value with respect to the rated Series 2006 Bonds by their Maturity Dates. The ratings will not address the payment of Turbo Redemptions or Sinking Fund Installments on the Series 2006 Bonds.

S&P currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the rated Series 2006 Bonds, have a "negative outlook." Moody's currently indicates that its ratings on all tobacco settlement securitizations, including its ratings of the rated Series 2006 Bonds, are "on watch direction uncertain."

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

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 Bonds from the Authority at an underwriters' discount of $3,491,327.01. The Underwriters will be obligated to purchase all of the Series 2006 Bonds if any are purchased. The initial public offering prices of the Series 2006 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 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2006 Bonds into investment trusts) at prices lower than such public offering prices.

LEGAL MATTERS

The validity of the Series 2006 Bonds and certain other legal matters are subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Bond Counsel. A complete copy of the proposed form of Bond Counsel opinion is set forth in Appendix E hereto. Certain legal matters with respect to the Authority, the Borrower and the County will be passed upon by County Counsel and Orrick, Herrington & Sutcliffe LLP. Certain legal matters will be passed upon for the Underwriters by their counsel, Hawkins Delafield & Wood LLP, Los Angeles, California.

EXPERTS

Global Insight

Global Insight has been retained as an independent econometric consultant. The Global Insight Cigarette Consumption Report attached as Appendix A hereto and the Global Insight Population Report attached as Appendix B hereto are included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2006 Bonds. The Global Insight Cigarette Consumption Report and the Global Insight Population Report should be read in their entirety.

FINANCIAL ADVISOR

Public Resources Advisory Group

Public Resources Advisory Group, Los Angeles, California, has served as Financial Advisor to the Authority in connection with the issuance of the Series 2006 Bonds. The Financial Advisor has assisted the Authority in matters relating to the planning, structuring, execution and delivery of the Series 2006 Bonds. The Financial Advisor has not audited, authenticated or otherwise independently verified the information set forth in the Offering Circular, or any other related information available to the Authority, with respect to accuracy and completeness of disclosure of such information. The Financial Advisor makes no guaranty, warranty or other representation respecting accuracy and completeness of the Offering Circular.

TOBACCO SECURITIZATION AUTHORITY OF SOUTHERN CALIFORNIA

By: /s/ Bill Horn
Chair

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX A

GLOBAL INSIGHT CIGARETTE CONSUMPTION REPORT

(THIS PAGE INTENTIONALLY LEFT BLANK)

A Forecast of U.S. Cigarette Consumption (2004-2046) for the Tobacco Securitization Authority of Southern California

Submitted to:

Tobacco Securitization Authority of Southern California

Prepared by:

Global Insight (USA), Inc.

May 26, 2006

Jim Diffley
Group Managing Director

Jeannine Cataldi
Senior Economist

Global Insight, Inc.
800 Baldwin Tower
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 2046. Our Base Case Forecast indicates that total consumption in 2046 will be 182 billion cigarettes (approximately 9 billion packs), a 54% decline from the 2003 level. From 2004 through 2046 the average annual rate of decline is projected to be 1.81%. On a per capita basis consumption is projected to fall at an average rate of 2.53% 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 2046 U.S. cigarette consumption could be as low as 169 billion and as high as 194 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.

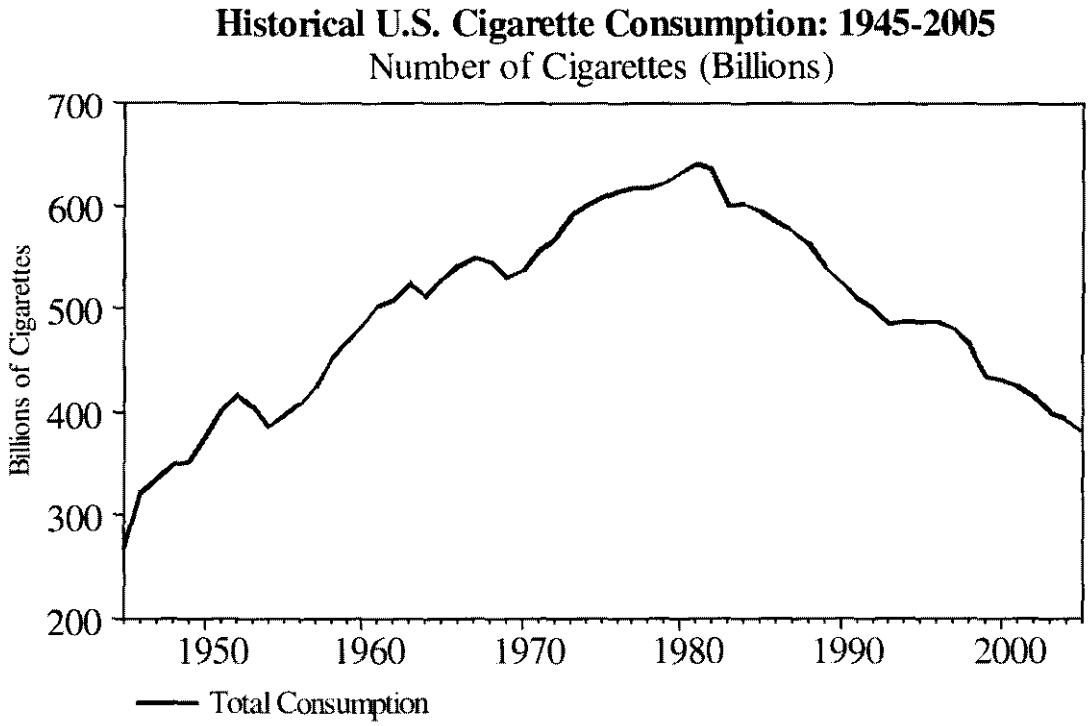
[1] On November 4, 2002, **DRI•WEFA** was re-named **Global Insight**.

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, and exceeded previous levels by 1934. Following the release of the Surgeon General's

[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.

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 2002-2005 to an annual rate of 2.70%.

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 eight years ended December 31, 2005[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
2005	381est	-3.05
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, 2005 estimates 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 86.1% of U.S. shipments in 2005. These top companies were Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 48.7%, 28.2%, and 9.2%, respectively of the domestic market in 2005. 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 2005, the federal government received $7.8 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $13.5 billion in 2005, 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 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%.

---

[7] Ibid.

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

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

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

A report from the New York City Youth Risk Behavior Survey finds that smoking among New York City high school students decreased by 52% from 1997 to 2005.[12] Over this period new York City has raised excise taxes to the highest in the nation and instituted a comprehensive indoor smoking ban.

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

---

[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.

[12] New York City Department of Health and Mental Hygiene. "Smoking among New York City Public High School Students". NYC Vital Signs. February 2006.

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 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.[13] (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.[14] 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.[15] 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.[16] 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

---

[13] Chalpouka FJ,Warner KE:P.5.

[14] *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.

[15] 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.

[16] 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%.[17]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[18] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of –0.46, implying that a 10% increase in price leads to a 4.6% reduction in smoking participation.[19]

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.[20] 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

[17] 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.
[18] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press. Copyright 2001.
[19] Powell et al. "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior". Impacteen. February 2003.
[20] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. http:\\tc.bmjjournals.com.

other products.[21] 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.[22]

Several new drugs may also appear on the market in the near future. The Food and Drug Administration (FDA) has approved varenicline, a Pfizer product to be marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. 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 is in Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with Nicotine molecules. On March 9, 2006, NicVAX received Fast Track Designation from the FDA, which is intended to expedite its review process. The company expects to move to Phase III trials in the second half of 2007. 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.[23] 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.

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

---

[21] Niaura, Raymond and Abrams, David B. "Smoking Cessation: Progress, Priorities, and Prospectus". Journal of Consulting and Clinical Psychology. June 2002.

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

[23] *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.

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 393 million in 2046. 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 (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. This report will consider any such fees as equivalent to excise taxes. As a result the population-weighted average state excise tax is now $0.913 per pack In 2006 at least 10 states are considering proposed excise tax increases, including increases of $1.00 in New York, and of up to $2.60 in California. The Texas legislature has approved a budget bill that would raise the state excise tax by $1.00 in January 2007. The governor is expected to sign the legislation.

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 $0.10 per pack. In June 2005 Philip Morris reduced its retail buydown by $0.05 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 April 2006 was $4.15 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.[24] Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[25] However, a few studies found cigarette consumption decreases as disposable income increases.[26] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[27] almost all adult smokers first use cigarettes by high

[24] *Source*: United States General Accounting Office. "Internet Cigarette Sales". GAO-02-743. August 2002.
[25] Ippolito, et al.; Fuji.
[26] Wasserman, et al.; Townsend et al.
[27] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.

school, and very little first use occurs after age 20.[28] One study examines the effects of youth smoking on future adult smoking.[29] 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.

Five states, Alabama, Georgia, Idaho, Kentucky and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., PepsiCo Inc. and Northwest Airlines, are now charging smokers higher premiums.

---

[28] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."

[29] *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.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[30]

The most comprehensive bans have been enacted since 1998 in 16 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 went 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. In 2006 Arkansas, Colorado, Hawaii, Utah, and Puerto Rico enacted similar legislation. It is expected that these restrictions will continue to proliferate. In 2006 at least one additional states, Ohio, is considering a comprehensive ban. California, effective July 1, 2005, 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 April 17, 2006, there were 2,216 municipalities with indoor smoking restrictions. Of these, 461 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 292 governments, and for bars by 215. 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.[31] The first extensive outdoor smoking restrictions were instituted on March 17, 2006 in Calabasas, California.

---

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

Based on the regression analysis using data from 1965 to 2003, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970's have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimate that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[32] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking, but have little influence on prevalence.[33] The study predicts that moving from no smoking restrictions at all to to the most restrictive bans reduces average smoking by from 5% to 8%.

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.

Smokeless Tobacco Products. Smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and spit-free. Chewing tobacco and dry snuff consumption has been declining in the U.S. in this decade, but moist snuff consumption has increased at an annual rate of approximately 5% since 2002, with over 5 million consumers. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006 the two largest U.S. cigarette manufacturers entered the market. Philip Morris is introducing a snuff product, Taboka, and Reynolds American has acquired Conway Company, the second largest domestic producer.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where 'snus', a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of

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

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

smoking among Swedish men.[34] The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Similar to the case of smoking bans, this report assumes that the trend decline in smoking projected in this forecast is sufficient to incorporate the negative impact that increasing use of snuff may have on cigarette consumption.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[35] and the American Medical Association[36] (AMA) both 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 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

---

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

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

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

by Farrelly, Pechacek, and Chaloupka.[37] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%. Tauras, et al. estimate that, had state tobacco control spending been maintained at the levels recommended by the CDC, youth smoking rates would have been from 3.3% to 13.5% lower.[38] Also, Farrelly et al. estimate that 22% of the decline in youth smoking from 1999 to 2002 was due to the national "truth" mass media campaign.[39] In 2002, New York City implemented a strategy which sharply increased excise taxes, banned smoking in bars and restaurants, distributed free nicotine patches, and expanded educational efforts. Research by Frieden et al. estimates that smoking prevalence in the City declines by 11% as a result of these measures, an effect consistent with the conclusions of the Surgeon General's Report.[40]

In May 2001 a Commission established by President Clinton in September 2000 released its final report on how to improve economic conditions in tobacco dependent economies while making sure that public health does not suffer in the process.[41] The Commission recommended moving from the current quota system to what would be called a Tobacco Equity Reduction Program (TERP). TERP would allow compensation to be rendered to quota owners for the loss in value of their quota assets as a result of a restructuring to a production permit system where permits would be issued annually to tobacco growers. Also created would be a Center for Tobacco-Dependent Communities, which would address any challenges faced during this period. Three public health proposals that were suggested by the Commission were: that states increase funding on tobacco cessation and prevention programs; that the FDA be allowed to regulate tobacco products in a "fair and equitable" manner; and that funding be included in Medicaid and Medicare coverage for smoking cessation. To be able to fund these recommendations, the Commission called for a 17-cent increase in the excise tax on all packs of cigarettes sold in the United States. The increased revenues would then be deposited into a fund and earmarked for the recommended programs. On February 13, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations, which included raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to discourage smoking and to fund anti-tobacco efforts.

Neither the Surgeon General's nor the Presidential Commission's report have resulted in a concerted nationwide program to implement their recommendations, though legislation

---

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

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

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

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

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

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.[42] Similarly, the Justice Department has indicated that, as part of a lawsuit against the tobacco companies, it may seek to require graphic health warnings covering 50% of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. A similar proposal is part of the World Health Organization's Framework Convention on Tobacco Control, which the U.S. may sign. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either greater levels of spending, or more effective programs. This is the common economic principle of diminishing returns.

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 went into effect May 1, 2006. Similar laws were enacted in October 2005 in California to take effect January 1, 2007, and in May 2006 in Illinois to take effect in 2008. New Hampshire also has legislation which may be enacted soon. Similar bills have been introduced in a number of other states. We do not believe that these statutes or a nationwide agreement on such standards will affect consumption noticeably. It will probably raise the cost of manufacture slightly, but we view it as a continuation of a long series of government actions that contribute to the trend decline in consumption, which has been incorporated into our model. The expense and availability of technology required in the manufacture of self-extinguishing cigarettes may put the smaller manufacturers at a slight competitive disadvantage, as their cost per pack would increase more relative to the cost per pack increase for the larger manufacturers.

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.

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

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 2046. It should also be noted that since our entire dataset incorporates the effect of the Surgeon General's health warning (1964), the impact of that variable too is accounted for in the forecast. Similarly the effect of nicotine dependence is incorporated into our entire dataset and influences the trend decline.

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

log (cpc)	=	57.7	-	0.024 * trend
	-	0.223 * log (cigprice)	-	0.106 * log (cigprice)(-1)
	+	0.270 * log (ydp96pc)	-	0.020 * smokeban

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

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2003 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

Our model is completed with two other equations:

(1) Total adult cigarette consumption =

cpc * U.S. adult population.

(2) Total cigarette consumption =

total adult cigarette consumption + total youth cigarette consumption.

We have measured the consumption level of cigarettes in the 12-17 age group by examining the difference between total consumption and total adult consumption. We then use the expected trend of youth smoking incidence to adjust for the volume of cigarette consumption in this age group. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 2 billion in 2046.

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% 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 $4.04 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 2006 to average $4.23 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 $26.87 by 2046, which is $8.10 in 2000 dollars. Relative to other goods, cigarette prices will rise by an average of 2.0% 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 2046 we assume that youth smoking will have declined at an average annual rate of 2.4% since 2001, or by 66% overall.

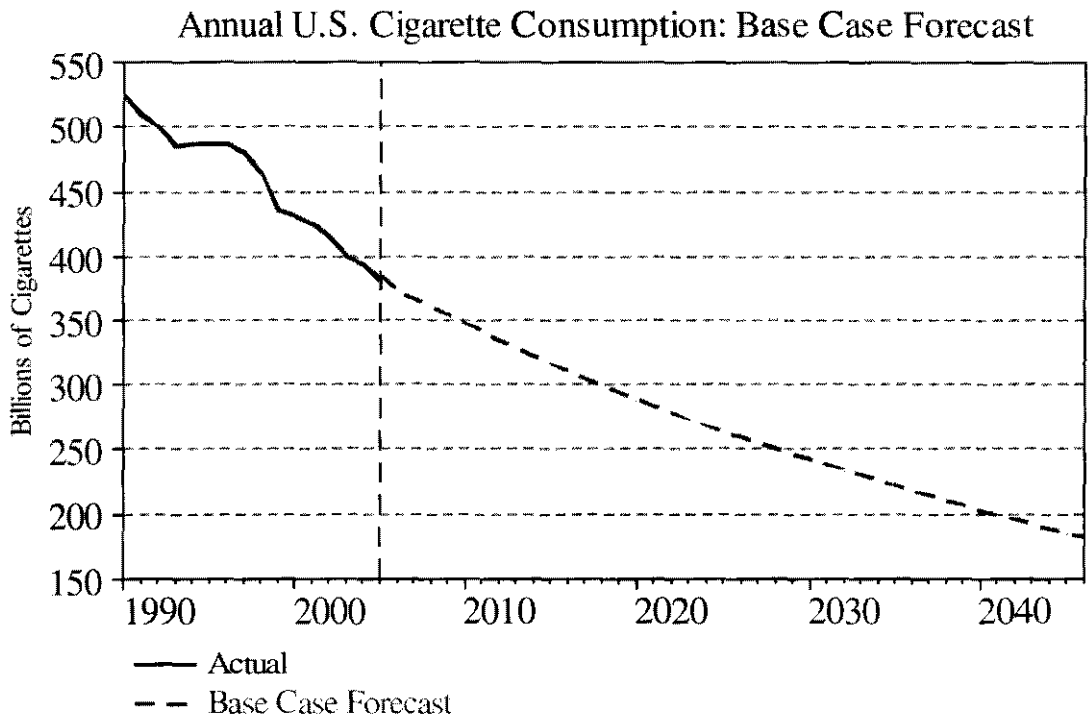
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

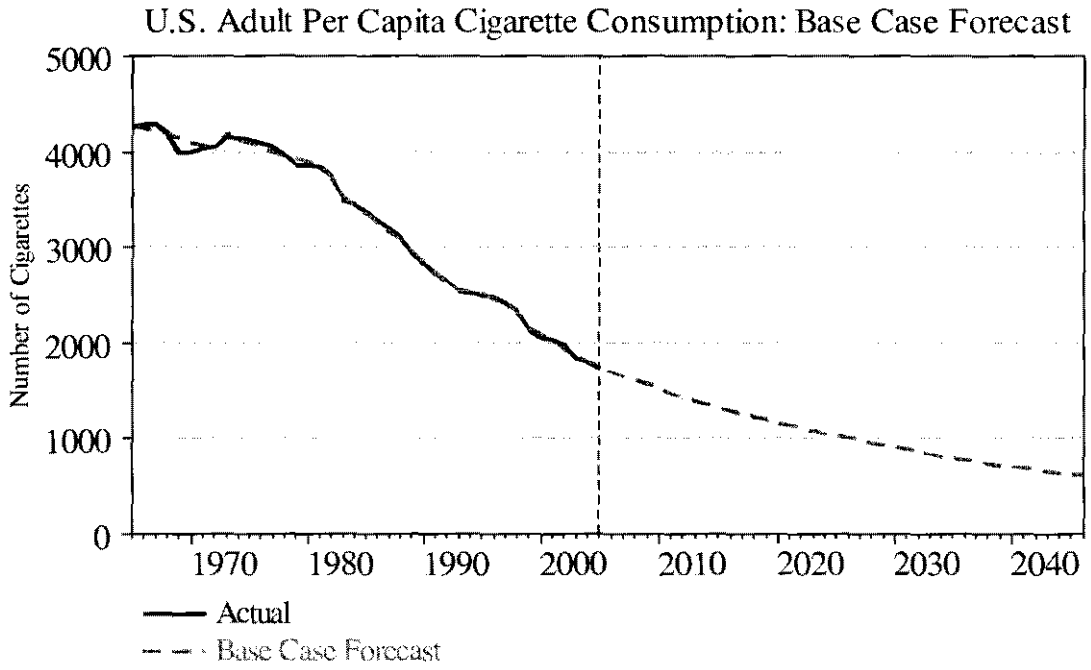
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2004 through 2046. 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% since 2003. These cigarettes are produced by a large number of manufacturers, including many who participate in the MSA. After significant gains earlier in the decade, imports to the U.S. have declined from a high of 23.1 billion sticks in 2003 to 18.1 billion in 2005. In 2005 industry shipments of 381 billion cigarettes were 3.4% lower than in 2004. Part of this decline can be attributed to two extra shipping days in the leap year 2004. For the first quarter of 2006, industry shipments of 88.5 billion were 0.5% higher than the first quarter of 2005. This comparison is also influenced by an extra shipping day.

On March 8 the National Association of Attorneys General and the American Legacy Foundation jointly announced that cigarette consumption in 2005 had fallen to 378 billion sticks. The estimate in this report, of 381 billion, is slightly higher. It is based on two sources. First, Reynolds American reported in February that the market research firm, MSAI, had estimated total industry shipments in 2005 of 381 billion. Second, the Alcohol and Tobacco Tax and Trade Bureau of the U.S. Department of Treasury reported on February 14, 2006, in their "Statistical Report – Tobacco", that U.S. manufacturers removed as taxable 362.96 billion cigarettes from production in 2005, and that imported cigarettes for consumption in 2005 totaled 18.13 billion. The total shipped for U.S. consumption is then 381.09 billion

After 2005, the rate of decline of consumption is projected to moderate and average less than 2% per year. From 2004 through 2046 the average annual rate of decline is projected to be 1.81%. On a per capita basis consumption is projected to fall at an average rate of 2.53% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 381 billion in 2005 to 373 billion in 2006, under 300 billion by 2018, and to under 200 billion by 2041.

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

This forecast differs from those we provided in similar studies in 2005 and 2006. In February 2006 full year data on industry shipments for 2005 were reported by the manufacturers and by the Alcohol and Tobacco Tax and Trade Bureau. From this data we estimate that consumption in 2005 was 381 billion cigarettes, 4 billion fewer than we had projected. This new data has been incorporated into this revised forecast. Its long term

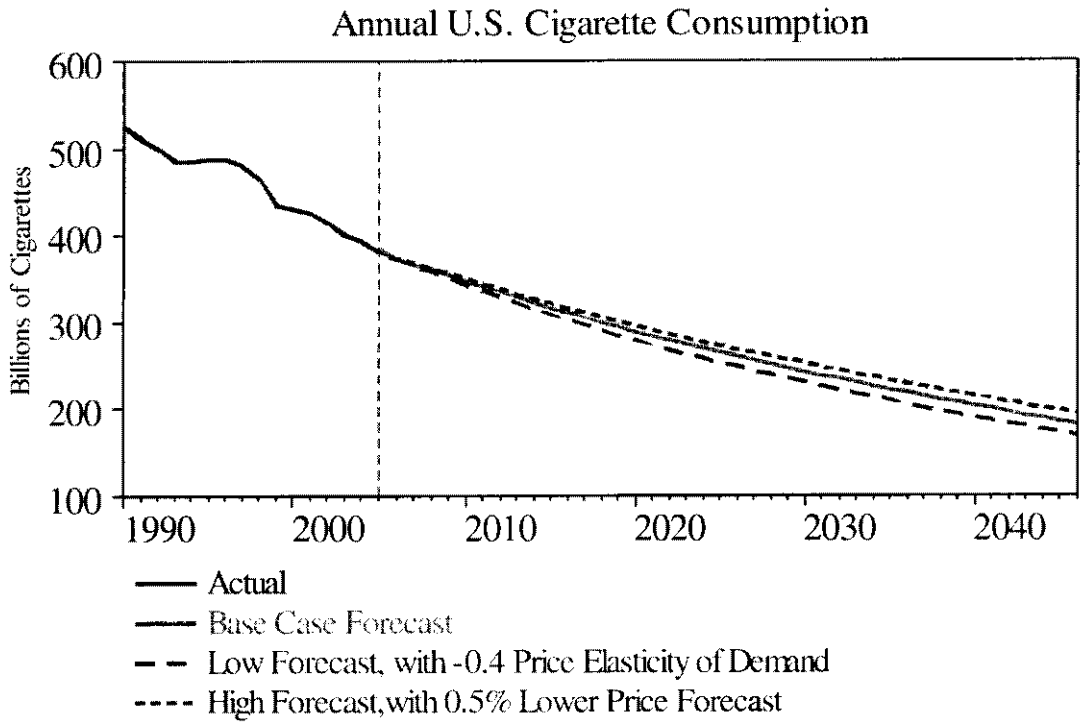
implications are that consumption levels in 2046 are forecast to be 182 billion, 3 billion fewer than the 185 billion in our forecasts of 2005.

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 1.81% to 1.67%, resulting in consumption of 194 billion in 2046.

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 1.99% and results in cigarette consumption of 169 billion in 2046.



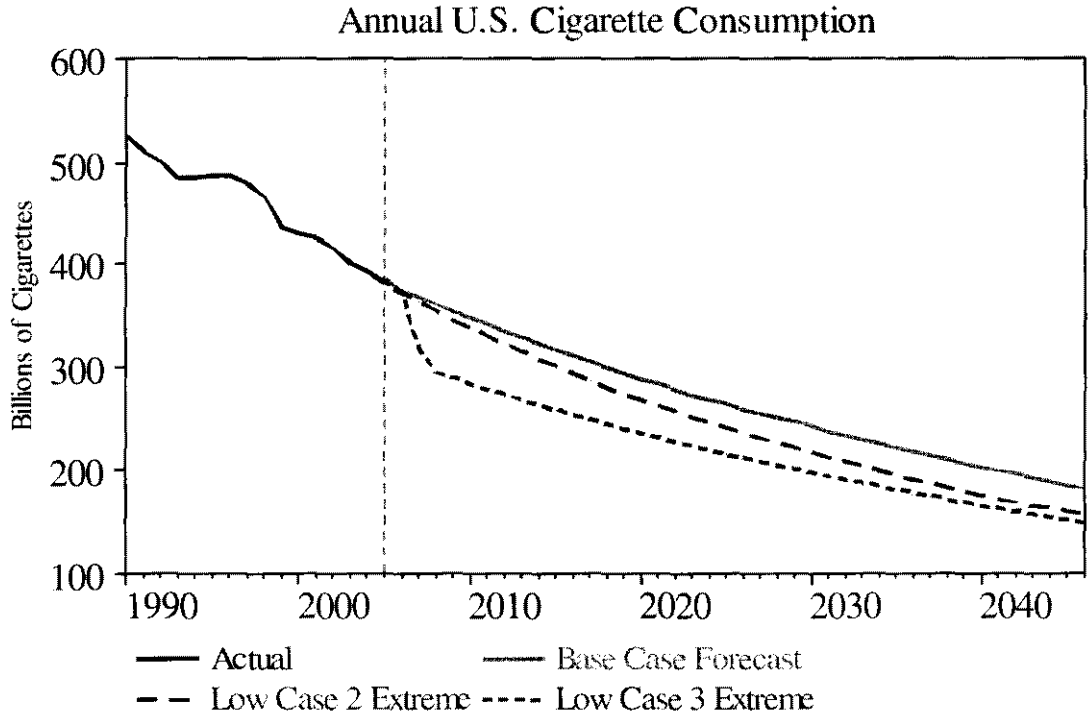
Hypothetical Stress Scenarios

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 2.16%, and results in demand of 157 billion cigarettes in 2046 (Low Case 2). This scenario would also be the result if, instead of a greater price sensitivity of smokers, we postulated an increased rate of cigarette price increase. Indeed, if cigarette prices, instead of averaging increases in real terms of 1.97% per year, accelerated to a pace of 3.45% annually, demand would also fall to 157 billion in 2046.

A second large negative stress is placed by postulating, in 2007, 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 2046, consumption will have fallen to 149 billion cigarettes, an average annual rate of decline of 2.27% (Low Case 3).

Alternative Forecasts

	2046 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	182	1.81
Low Case 1	169	1.99
High Alternative	194	1.67
Low Case 2	157	2.16
Low Case 3	149	2.27



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under two alternative annual rates of decline, 2.5%, 3%, 3.5% and 4%. Under these scenarios consumption in 2046 falls to 135 billion, 109 billion, 88 billion, and 71 billion respectively. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

Base Case Forecast: Assumptions for Explanatory Variables

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
1965	4.84	4.13	1.95	0.04		
1966	4.06	0.92	1.28	0.04		
1967	3.27	0.72	1.39	0.05		
1968	3.50	1.89	1.56	0.05		
1969	2.06	0.00	1.69	0.06		
1970	3.02	2.24	2.00	0.05		
1971	3.28	0.12	2.27	0.06		
1972	3.66	2.08	2.85	0.06		
1973	5.73	-3.29	2.03	0.07		
1974	-1.62	-5.49	2.05	0.07		
1975	1.30	-1.87	2.12	0.05		
1976	2.92	-1.40	2.07	0.05		
1977	2.46	-1.60	1.91	0.07		
1978	3.58	-2.05	1.91	0.06		
1979	1.35	-4.73	2.00	0.05		
1980	0.06	-5.03	1.96	0.05		
1981	1.63	-2.11	1.73	0.06		
1982	1.20	4.80	1.64	0.05		
1983	2.35	15.84	1.46	0.04		
1984	6.63	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.21	4.84	1.38	0.06		
1987	0.83	3.36	1.23	0.05		
1988	3.32	4.83	1.26	0.05		
1989	1.82	7.64	1.35	0.05		
1990	0.72	4.71	0.89	0.06	7.96	
1991	-0.81	7.16	0.96	0.06	7.72	
1992	2.08	5.24	0.99	0.06	7.62	
1993	-0.24	0.91	1.02	0.06	7.12	
1994	1.48	-6.11	0.95	0.07	7.21	
1995	1.58	-0.21	0.85	0.07	7.76	
1996	1.77	0.18	0.89	0.08	7.54	
1997	2.30	2.31	1.27	0.08	6.58	
1998	4.63	11.03	1.15	0.08	6.30	2.20
1999	1.80	26.72	1.13	0.08	5.92	2.88
2000	3.71	7.47	1.14	0.08	5.92	3.20
2001	0.89	4.36	1.10	0.08	5.92	3.45
2002	2.06	5.76	1.02	0.08	5.91	3.71
2003	1.32	-0.64	0.96	0.08	5.87	3.77
2004	2.43	-0.75	0.96	0.08	5.84	3.84
2005	0.48	1.68	0.98	0.08	5.82	4.12
2006	2.24	2.59	0.99	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	2.20	3.10	1.02	0.07	5.77	4.92

Base Case Forecast: Assumptions for Explanatory Variables (Cont.)

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Nominal Price Per Pack
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*Fraction*	*Billions*	*$ (Current)*
2010	2.17	2.61	1.00	0.07	5.62	5.17
2011	2.10	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
2043	2.11	1.53	0.66	0.03	2.22	23.98
2044	2.11	1.53	0.66	0.03	2.08	25.01
2045	2.11	1.68	0.67	0.03	2.02	26.07
2046	2.11	1.66	0.68	0.03	2.02	27.14

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2046)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2320	-4.25	465.00	23.25	-3.13
1999	2136	-7.93	435.00	21.75	-6.45
2000	2056	-3.75	430.00	21.50	-1.15
2001	2026	-1.46	425.00	21.25	-1.16
2002	1979	-2.32	415.00	20.75	-2.35
2003	1837	-7.18	400.00	20.00	-3.61
2004	1791	-2.50	393.00	19.65	-1.75
2005	1719	-3.99	381.00	19.05	-3.05
2006	1670	-2.85	373.34	18.67	-2.01
2007	1625	-2.70	366.86	18.34	-1.73
2008	1581	-2.72	360.59	18.03	-1.71
2009	1537	-2.82	353.96	17.70	-1.84

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2046) (Cont.)

	Per Capita Consumption	Growth Rate	Total Consumption	Total Consumption	Growth Rate
		(%)	*(billions)*	*(billions of packs)*	*(%)*
2010	1494	-2.76	347.62	17.38	-1.79
2011	1454	-2.72	341.27	17.06	-1.83
2012	1414	-2.70	334.93	16.75	-1.86
2013	1376	-2.69	328.54	16.43	-1.91
2014	1338	-2.76	322.14	16.11	-1.95
2015	1303	-2.62	316.45	15.82	-1.77
2016	1269	-2.61	310.82	15.54	-1.78
2017	1236	-2.63	305.06	15.25	-1.85
2018	1203	-2.62	299.41	14.97	-1.85
2019	1172	-2.61	293.71	14.69	-1.90
2020	1142	-2.53	288.43	14.42	-1.80
2021	1113	-2.56	283.17	14.16	-1.83
2022	1085	-2.51	278.11	13.91	-1.79
2023	1058	-2.54	273.09	13.65	-1.81
2024	1032	-2.49	268.43	13.42	-1.71
2025	1006	-2.45	263.84	13.19	-1.71
2026	982	-2.44	259.36	12.97	-1.70
2027	958	-2.44	254.97	12.75	-1.69
2028	934	-2.43	250.69	12.53	-1.68
2029	912	-2.43	246.48	12.32	-1.68
2030	889	-2.49	242.34	12.12	-1.68
2031	867	-2.45	238.16	11.91	-1.72
2032	846	-2.42	234.12	11.71	-1.70
2033	826	-2.41	230.14	11.51	-1.70
2034	806	-2.41	226.19	11.31	-1.72
2035	785	-2.59	221.88	11.09	-1.91
2036	766	-2.49	217.98	10.90	-1.76
2037	747	-2.45	214.19	10.71	-1.74
2038	729	-2.42	210.53	10.53	-1.71
2039	711	-2.44	206.72	10.34	-1.81
2040	694	-2.41	203.02	10.15	-1.79
2041	677	-2.38	199.44	9.97	-1.77
2042	661	-2.43	195.80	9.79	-1.83
2043	645	-2.42	192.24	9.61	-1.82
2044	640	-2.41	188.76	9.59	-1.81
2045	625	-2.42	185.34	9.27	-1.81
2046	609	-2.41	182.02	9.10	-1.79

Base Case Forecast and Low Case Extreme Projections

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	381.00	19.05	-3.05	381.00	19.05	-3.05	381.00	19.05	-3.05
2006	373.34	18.67	-2.01	372.50	18.62	-2.23	373.99	18.70	-1.84
2007	366.86	18.34	-1.73	365.11	18.26	-1.98	368.10	18.40	-1.57
2008	360.59	18.03	-1.71	357.81	17.89	-2.00	362.21	18.11	-1.60
2009	353.96	17.70	-1.84	350.22	17.51	-2.12	356.09	17.80	-1.69
2010	347.62	17.38	-1.79	343.12	17.16	-2.03	350.25	17.51	-1.64
2011	341.27	17.06	-1.83	336.05	16.80	-2.06	344.41	17.22	-1.67
2012	334.93	16.75	-1.86	329.04	16.45	-2.09	338.53	16.93	-1.71
2013	328.54	16.43	-1.91	322.01	16.10	-2.14	332.58	16.63	-1.76
2014	322.14	16.11	-1.95	314.92	15.75	-2.20	326.63	16.33	-1.79
2015	316.45	15.82	-1.77	308.80	15.44	-1.95	321.35	16.07	-1.62
2016	310.82	15.54	-1.78	302.65	15.13	-1.99	316.12	15.81	-1.63
2017	305.06	15.25	-1.85	296.41	14.82	-2.06	310.76	15.54	-1.69
2018	299.41	14.97	-1.85	290.33	14.52	-2.05	305.50	15.28	-1.69
2019	293.71	14.69	-1.90	284.19	14.21	-2.11	300.15	15.01	-1.75
2020	288.43	14.42	-1.80	278.57	13.93	-1.98	295.21	14.76	-1.65
2021	283.17	14.16	-1.83	272.93	13.65	-2.03	290.26	14.51	-1.68
2022	278.11	13.91	-1.79	267.62	13.38	-1.95	285.54	14.28	-1.63
2023	273.09	13.65	-1.81	262.28	13.11	-2.00	280.84	14.04	-1.65
2024	268.43	13.42	-1.71	257.39	12.87	-1.87	276.50	13.83	-1.55
2025	263.84	13.19	-1.71	252.57	12.63	-1.87	272.21	13.61	-1.55
2026	259.36	12.97	-1.70	247.88	12.39	-1.86	268.02	13.40	-1.54
2027	254.97	12.75	-1.69	243.29	12.16	-1.85	263.90	13.19	-1.54
2028	250.69	12.53	-1.68	238.81	11.94	-1.84	259.86	12.99	-1.53
2029	246.48	12.32	-1.68	234.45	11.72	-1.83	255.91	12.80	-1.52
2030	242.34	12.12	-1.68	230.06	11.50	-1.87	251.99	12.60	-1.53
2031	238.16	11.91	-1.72	225.75	11.29	-1.87	248.05	12.40	-1.56
2032	234.12	11.71	-1.70	221.58	11.08	-1.85	244.24	12.21	-1.54
2033	230.14	11.51	-1.70	217.49	10.87	-1.85	240.46	12.02	-1.55
2034	226.19	11.31	-1.72	213.42	10.67	-1.87	236.72	11.84	-1.56
2035	221.88	11.09	-1.91	208.86	10.44	-2.14	232.56	11.63	-1.76
2036	217.98	10.90	-1.76	204.90	10.25	-1.90	228.84	11.44	-1.60
2037	214.19	10.71	-1.74	200.99	10.05	-1.91	225.23	11.26	-1.58
2038	210.53	10.53	-1.71	197.27	9.86	-1.85	221.74	11.09	-1.55
2039	206.72	10.34	-1.81	193.37	9.67	-1.98	218.06	10.90	-1.66
2040	203.02	10.15	-1.79	189.64	9.48	-1.93	214.51	10.73	-1.63
2041	199.44	9.97	-1.77	186.03	9.30	-1.91	211.05	10.55	-1.62
2042	195.80	9.79	-1.83	182.31	9.12	-2.00	207.51	10.38	-1.68
2043	192.24	9.61	-1.82	178.76	8.94	-1.95	204.09	10.20	-1.65
2044	188.76	9.59	-1.81	175.29	8.89	-1.94	200.74	10.22	-1.64
2045	185.34	9.27	-1.81	171.92	8.60	-1.93	197.44	9.87	-1.64
2046	182.02	9.10	-1.79	168.63	8.43	-1.91	194.22	9.71	-1.63

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	381.00	19.05	-3.05	381.00	19.05	-3.05	381.00	19.05	-3.05
2006	373.34	18.67	-2.01	371.51	18.58	-2.49	373.34	18.67	-2.01
2007	366.86	18.34	-1.73	363.10	18.15	-2.26	319.24	15.96	-14.49
2008	360.59	18.03	-1.71	354.86	17.74	-2.27	294.49	14.72	-7.75
2009	353.96	17.70	-1.84	346.24	17.31	-2.43	289.07	14.45	-1.84
2010	347.62	17.38	-1.79	338.31	16.92	-2.29	283.90	14.20	-1.79
2011	341.27	17.06	-1.83	330.47	16.52	-2.32	278.71	13.94	-1.83
2012	334.93	16.75	-1.86	322.74	16.14	-2.34	273.53	13.68	-1.86
2013	328.54	16.43	-1.91	315.07	15.75	-2.38	268.32	13.42	-1.91
2014	322.14	16.11	-1.95	307.22	15.36	-2.49	263.09	13.15	-1.95
2015	316.45	15.82	-1.77	300.63	15.03	-2.15	258.44	12.92	-1.77
2016	310.82	15.54	-1.78	293.93	14.70	-2.23	253.84	12.69	-1.78
2017	305.06	15.25	-1.85	287.19	14.36	-2.29	249.14	12.46	-1.85
2018	299.41	14.97	-1.85	280.63	14.03	-2.28	244.52	12.23	-1.85
2019	293.71	14.69	-1.90	274.06	13.70	-2.34	239.87	11.99	-1.90
2020	288.43	14.42	-1.80	268.15	13.41	-2.16	235.56	11.78	-1.80
2021	283.17	14.16	-1.83	262.13	13.11	-2.25	231.26	11.56	-1.83
2022	278.11	13.91	-1.79	256.53	12.83	-2.14	227.13	11.36	-1.79
2023	273.09	13.65	-1.81	250.85	12.54	-2.22	223.03	11.15	-1.81
2024	268.43	13.42	-1.71	245.72	12.29	-2.05	219.23	10.96	-1.71
2025	263.84	13.19	-1.71	240.68	12.03	-2.05	215.48	10.77	-1.71
2026	259.36	12.97	-1.70	235.77	11.79	-2.04	211.81	10.59	-1.70
2027	254.97	12.75	-1.69	230.98	11.55	-2.03	208.23	10.41	-1.69
2028	250.69	12.53	-1.68	226.34	11.32	-2.01	204.74	10.24	-1.68
2029	246.48	12.32	-1.68	221.79	11.09	-2.01	201.30	10.06	-1.68
2030	242.34	12.12	-1.68	217.20	10.86	-2.07	197.91	9.90	-1.68
2031	238.16	11.91	-1.72	212.76	10.64	-2.04	194.50	9.73	-1.72
2032	234.12	11.71	-1.70	208.47	10.42	-2.02	191.20	9.56	-1.70
2033	230.14	11.51	-1.70	204.26	10.21	-2.02	187.96	9.40	-1.70
2034	226.19	11.31	-1.72	200.12	10.01	-2.03	184.73	9.24	-1.72
2035	221.88	11.09	-1.91	195.35	9.77	-2.39	181.21	9.06	-1.91
2036	217.98	10.90	-1.76	191.31	9.57	-2.07	178.02	8.90	-1.76
2037	214.19	10.71	-1.74	187.31	9.37	-2.09	174.93	8.75	-1.74
2038	210.53	10.53	-1.71	183.55	9.18	-2.01	171.94	8.60	-1.71
2039	206.72	10.34	-1.81	179.57	8.98	-2.17	168.83	8.44	-1.81
2040	203.02	10.15	-1.79	175.82	8.79	-2.09	165.81	8.29	-1.79
2041	199.44	9.97	-1.77	172.19	8.61	-2.07	162.88	8.14	-1.77
2042	195.80	9.79	-1.83	168.44	8.42	-2.18	159.90	8.00	-1.83
2043	192.24	9.61	-1.82	164.90	8.25	-2.10	157.00	7.85	-1.82
2044	188.76	9.59	-1.81	163.43	8.17	-2.09	154.16	8.35	-1.81
2045	185.34	9.42	-1.78	160.01	8.00	-2.10	151.41	7.57	-1.78
2046	182.02	9.26	-1.72	156.68	7.83	-2.08	148.81	7.44	-1.72

Alternative Constant Rate Decline Projections

Year	2.5%			3.0%		
	Cigarettes	*Packs (billions)*	*Growth Rate*	*Cigarettes*	*Packs (billions)*	*Growth Rate*
2004	393.00	19.65	-1.75	393.00	19.65	-4.00
2005	381.00	19.05	-3.05	381.00	19.05	-3.05
2006	371.48	18.57	-2.50	369.57	18.48	-3.00
2007	362.19	18.11	-2.50	358.48	17.92	-3.00
2008	353.13	17.66	-2.50	347.73	17.39	-3.00
2009	344.31	17.22	-2.50	337.30	16.86	-3.00
2010	335.70	16.78	-2.50	327.18	16.36	-3.00
2011	327.31	16.37	-2.50	317.36	15.87	-3.00
2012	319.12	15.96	-2.50	307.84	15.39	-3.00
2013	311.14	15.56	-2.50	298.61	14.93	-3.00
2014	303.37	15.17	-2.50	289.65	14.48	-3.00
2015	295.78	14.79	-2.50	280.96	14.05	-3.00
2016	288.39	14.42	-2.50	272.53	13.63	-3.00
2017	281.18	14.06	-2.50	264.35	13.22	-3.00
2018	274.15	13.71	-2.50	256.42	12.82	-3.00
2019	267.29	13.36	-2.50	248.73	12.44	-3.00
2020	260.61	13.03	-2.50	241.27	12.06	-3.00
2021	254.10	12.70	-2.50	234.03	11.70	-3.00
2022	247.74	12.39	-2.50	227.01	11.35	-3.00
2023	241.55	12.08	-2.50	220.20	11.01	-3.00
2024	235.51	11.78	-2.50	213.59	10.68	-3.00
2025	229.62	11.48	-2.50	207.19	10.36	-3.00
2026	223.88	11.19	-2.50	200.97	10.05	-3.00
2027	218.29	10.91	-2.50	194.94	9.75	-3.00
2028	212.83	10.64	-2.50	189.09	9.45	-3.00
2029	207.51	10.38	-2.50	183.42	9.17	-3.00
2030	202.32	10.12	-2.50	177.92	8.90	-3.00
2031	197.26	9.86	-2.50	172.58	8.63	-3.00
2032	192.33	9.62	-2.50	167.40	8.37	-3.00
2033	187.52	9.38	-2.50	162.38	8.12	-3.00
2034	182.83	9.14	-2.50	157.51	7.88	-3.00
2035	178.26	8.91	-2.50	152.78	7.64	-3.00
2036	173.81	8.69	-2.50	148.20	7.41	-3.00
2037	169.46	8.47	-2.50	143.75	7.19	-3.00
2038	165.23	8.26	-2.50	139.44	6.97	-3.00
2039	161.09	8.05	-2.50	135.26	6.76	-3.00
2040	157.07	7.85	-2.50	131.20	6.56	-3.00
2041	153.14	7.66	-2.50	127.26	6.36	-3.00
2042	149.31	7.47	-2.50	123.45	6.17	-3.00
2043	145.58	7.28	-2.50	119.74	5.99	-3.00
2044	141.94	7.10	-2.50	116.15	5.81	-3.00
2045	138.39	6.92	-2.50	112.67	5.63	-3.00
2046	134.93	6.75	-2.50	109.29	5.46	-3.00

Alternative Constant Rate Decline Projections (cont'd)

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	381.00	19.05	-3.05	381.00	19.05	-3.05
2006	367.67	18.38	-3.50	365.76	18.29	-4.00
2007	354.80	17.74	-3.50	351.13	17.56	-4.00
2008	342.38	17.12	-3.50	337.08	16.85	-4.00
2009	330.40	16.52	-3.50	323.60	16.18	-4.00
2010	318.83	15.94	-3.50	310.66	15.53	-4.00
2011	307.67	15.38	-3.50	298.23	14.91	-4.00
2012	296.90	14.85	-3.50	286.30	14.32	-4.00
2013	286.51	14.33	-3.50	274.85	13.74	-4.00
2014	276.48	13.82	-3.50	263.86	13.19	-4.00
2015	266.81	13.34	-3.50	253.30	12.67	-4.00
2016	257.47	12.87	-3.50	243.17	12.16	-4.00
2017	248.46	12.42	-3.50	233.44	11.67	-4.00
2018	239.76	11.99	-3.50	224.10	11.21	-4.00
2019	231.37	11.57	-3.50	215.14	10.76	-4.00
2020	223.27	11.16	-3.50	206.53	10.33	-4.00
2021	215.46	10.77	-3.50	198.27	9.91	-4.00
2022	207.92	10.40	-3.50	190.34	9.52	-4.00
2023	200.64	10.03	-3.50	182.73	9.14	-4.00
2024	193.62	9.68	-3.50	175.42	8.77	-4.00
2025	186.84	9.34	-3.50	168.40	8.42	-4.00
2026	180.30	9.02	-3.50	161.67	8.08	-4.00
2027	173.99	8.70	-3.50	155.20	7.76	-4.00
2027	173.99	8.70	-3.50	155.20	7.76	-4.00
2028	167.90	8.40	-3.50	148.99	7.45	-4.00
2029	162.02	8.10	-3.50	143.03	7.15	-4.00
2030	156.35	7.82	-3.50	137.31	6.87	-4.00
2031	150.88	7.54	-3.50	131.82	6.59	-4.00
2032	145.60	7.28	-3.50	126.55	6.33	-4.00
2033	140.50	7.03	-3.50	121.48	6.07	-4.00
2034	135.59	6.78	-3.50	116.62	5.83	-4.00
2035	130.84	6.54	-3.50	111.96	5.60	-4.00
2036	126.26	6.31	-3.50	107.48	5.37	-4.00
2037	121.84	6.09	-3.50	103.18	5.16	-4.00
2038	117.58	5.88	-3.50	99.05	4.95	-4.00
2039	113.46	5.67	-3.50	95.09	4.75	-4.00
2040	109.49	5.47	-3.50	91.29	4.56	-4.00
2041	105.66	5.28	-3.50	87.64	4.38	-4.00
2042	101.96	5.10	-3.50	84.13	4.21	-4.00
2043	98.39	4.92	-3.50	80.77	4.04	-4.00
2044	94.95	4.75	-3.50	77.54	3.88	-4.00
2045	91.63	4.58	-3.50	74.43	3.72	-4.00
2046	88.42	4.42	-3.50	71.46	3.57	-4.00

Appendix : References

American Lung Association. *State Legislated Actions on Tobacco Issues*, 2002.

Baltagi BH, Goel RK. Quasi-experimental price elasticities of cigarette demand and the bootlegging effect. *American Journal of Agricultural Economics* 1987, 69(4):750-4.

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

Becker GS, Murphy KM. A theory of rational addiction. *Journal of Political Economy* 1988;96(4):675-700.

Bitton, asaf; Fichtenberg, Caroline; Glantz, Stanton. "Reducing Smoking Prevalence to 10% in Five Years. *Journal of the American Medical Association* 2001, 286:2733-4.

Borio, Gene. "Tobacco Timeline," 1998.

Capehart, T. U.S. Tobacco Farming Trends. *Tobacco Situation & Outlook* U.S. Department of Agriculture, Economic Research Service, TBS-243; April 1999.

Chaloupka FJ, Warner KE. *The Economics of Smoking*. National Bureau of Economic Research, Cambridge, March 1999.

Center for Disease Control, *Morbidity and Mortality Weekly Report*, "Tobacco Use Among Middle and High School Students-United States, 2002. November 14, 2003.

Center for Disease Control, *Morbidity and Mortality Weekly Report*, "Trends in Cigarette Smoking Among High School Students-United States, 1991-2002", May 17,2002.

Center for Disease Control, *Morbidity and Mortality Weekly Report*, "Cigarette Smoking Among Adults--United States, 2004," November 11, 2005.

Center for Disease Control, Morbidity and Mortality Weekly Report, "Youth Risk Behavior Surveillance – United States, 1999", June 9, 2000.

Center for Disease Control, *Morbidity and Mortality Weekly Report*, "Cigarette Smoking Among Adults – United States, 1995," December 26, 1997.

Center for Disease Control, *Morbidity and Mortality Weekly Report*, "State Laws on Tobacco Control-United States, 1995," November 3, 1995.

Centers for Disease Control and Prevention. *CDC Surveillance Summaries*, November 2, 2001. MMWR 2001; 50 (No. SS-4).

Center for Disease Control, Office on Smoking and Health, http://www.cdc.gov/tobacco.

Chaloupka, Frank, Cummings, K M, Morley,CP, and Horan, JK. "Tax, price, and cigarette smoking: evidence from the tobacco documents and implications for tobacco company marketing strategies". Tobacco Control 2002; 11(Supp I):i62-i71.

Chaloupka, Frank and Jha, Prabhat, editors. "Tobacco Control in Developing Countries". Oxford University Press, New York, NY. Copyright 2000.

Colman, Greg and Remler, Dahlia K., "Vertical Equity Consequences of Very High Cigarette Tax Increases: If the Poor are the Ones Smoking, How Could Cigarette Tax Increases be Progressive". Working Paper No. W10906, National Bureau of Economic Research, November 2004.

Connolly, Alpert, Rees, Carpenter, Wayne, Vallone, and Kish, "Effect of the New York State Cigarette Fire Safety Standard on Ignition Propensity, Smoke Constituents, and the Consumer Market", *Tobacco Control*, 2005:14.

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

Cummings, K. Michael and Hyland, Andrew, "Impact of Nicotine Replacement Therapy on Smoking Behavior", *Annual Review of Public Health*, 2005-03-16.

Czart, Christina; Pacula, Rosalie Liccardo; Chaloupka, Frank; and Wechsler, Henry. "The impact of prices and control policies on cigarette smoking among college students". Published in: Contemporary Economic Policy. Western Economic Association, Copyright April 2001.

Economic Research Service. *Tobacco Summary*, U.S. Department of Agriculture, TBS-243; April 1999.

Economic Research Service. *Tobacco Summary*, U.S. Department of Agriculture, TBS-244; September 1999.

Economic Research Service. *Tobacco*, U.S. Department of Agriculture, TBS-254; April 2003.

Economic Research Service. *Tobacco Outlook*, U.S. Department of Agriculture, TBS-258; April 2005.

Economic Research Service. *Tobacco Outlook*, U.S. Department of Agriculture, TBS-260; April 2006.

Elster J. *Ulysses and the Sirens: Studies in Rationality and Irrationality*. Cambridge: Cambridge University Press, 1979.

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.

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.

Farrelly, Matthew C.; Pechacek, Terry F.; Chaloupka, Frank A. "The Impact of Tobacco Control Program Expenditures on Aggregate Cigarette Sales: 1981-1998. Working Paper No. W8691, National Bureau of Economic Research, 2001.

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

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

Fujii ET. "The Demand for Cigarettes: Further Empirical Evidence and its Implications for Public Policy." *Applied Economics* 1980; 12:479-89.

Gale, F. Tobacco Dollars and Jobs. *Tobacco Situation & Outlook* U.S. Department of Agriculture, Economic Research Service, TBS-239; Sept 1997:37-43.

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

Gruber, Jonathan. "Tobacco At the Crossroads: The Past and Future of Smoking Regulation in the United States". *Journal of Economic Perspectives*, Volume 15, Number 2, Spring 2001:193-212.

Gruber, Jonathan, editor. "Risky Behavior Among Youths". National Bureau of Economic Research, University of Chicago Press; Copyright 2001.

Gruber, Jonathan and Koszegi, Botond, "Is Addiction "Rational"? Theory and Evidence", *Quarterly Journal of Economics*, 2001; 116(4), 1261-1305.

Gruber, Jonathan, Sen, Anindya, and Stabile, Mark, "Estimating Price Elasticities When There Is Smuggling: The Sensitivity of Smoking to Price in Canada", Working Paper No. W8962, National Bureau of Economic Research, 2002.

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

Guindon GE, Tobin S, Yach D. "Trends and Affordability of Cigarette Prices: Ample Room for Tax Increases and Related Health Gains". *Tobacco Control.* 2002;11:35-43.

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

Harris, Jeffrey E. "A Working Model For Predicting the Consumption and Revenue Impacts of Large Increases in the U.S. Federal Cigarette Excise Tax" (July 1, 1994).

Henningfield, Fant, Buchhalter, and Stitzer. "Pharmacology for Nicotine Dependence". *A Cancer Journal for Clinicians.* September/October 2005.

Hu, The-wei; Sung, Hai-Yen; Keeler, Theodore E.; and Marciniak, Martin. "Cigarette Consumption and sales of Nicotine Replacement Products". Tobacco Control, TC Online, Summer 2000. http://tc.bmjjournals.com/cgi/content/full/9/suppl_2/ii60.

Hursh SR, Bauman RA. The behavioral analysis of demand. In: Green L, Kagel JH, editors. *Advances in Behavioral Economics. Volume 1.* Norwood (NJ): Ablex Publishing Corporation, 1987:117-65.

Institute for Social Research, University of Michigan. "Monitoring the Future Study," December 2005.

Ippolito RA, Murphy RD, Sant D. *Staff Report on Consumer Responses to Cigarette Health Information.* Washington: Federal Trade Commision, 1979.

Lantz Paula M, Jacobson Peter D, Warner Kenneth E, Wasserman Jeffrey, Pollack Harold A, Berson Julie, Ahlstrom Alexis, "Investing in Youth Tobacco Control: A Review of Smoking Prevention and Control Strategies". *Tobacco Control* 2000; 9:47-63.

Levy, David T. and Friend, Karen. "A Computer Simulation Model of Mass Media Interventions Directed at Tobacco Use". *Preventive Medicine* 200132: 284-294.

Moore, Michael J. and Hughes, James W. "The Health Care Consequences of Smoking and its Regulation". National Bureau of Economic Research, Copyright 2000.

Niaura, Raymond and Abrams, David B. "Smoking Cessation: Progress, Priorities, and Prospectus". *Journal of Consulting and Clinical Psychology* 2002; 70(3): 494-509.

National Cancer Institute, "Changing Adolescent Smoking Prevalence". *Smoking and Tobacco Control Monograph 14*, March 2002.

New York City Department of Health and Mental Hygiene. "Smoking among New York City Public High School Students". *NYC Vital Signs.* February 2006.

President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health. "Tobacco at a Crossroad: A Call for Action". May 14, 2001.

Rabin, Robert L. and Sugarman, Stephen D. eds. *Regulating Tobacco.* Oxford University Press 2001.

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

Ross, Hana and Chaloupka, Frank, J. "The Effect of Cigarette Prices on Youth Smoking", Research Paper Series No. 7, ImpacTeen, February 2001.

Schelling TC. "Self-Command in Practice, in Policy and in a Theory of Rational Choice." *American Economic Review* 1984; 40 (1):141-59.

Stillman, Frances A., Hartman, Anne M., Graubard, Barry I., Gilpin, Elizaberh A., Murray, David M., and Gibson, James T. "Evaluation of the American Stop Smoking Intervention Study (ASSIST): A Report of Outcomes" *Journal of the National Cancer Institute.* Vol.95, No 22, November 19, 2003.

Substance Abuse and Mental Health Services Administration, National Survey on Drug Abuse and Health, September 5, 2003.

Sumner DA, Alston JM. *Removal of Price Supports and Supply Controls for U.S. Tobacco : An Economic Analysis of the Impact.* Washington: National Planning Association, 1985.

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

Surgeon General's 1988 Report, "The Health Consequences of Smoking - Nicotine Addiction".

Sweanor DT, Martial LR. *The Smuggling of Tobacco Products: Lessons from Canada.* Ottawa (Canada): Non-Smokers' Rights Association/Smoking and Health Action Foundation, 1994.

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

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.

Taurus, John A. and Chaloupka, Frank J.. "The Demand for Nicotine Replacement Therapies". Working Paper No. 8332, National Bureau of Economic Research, June 2001.

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.

Tauras, John A.; O'Malley, Patrick M.; and Johnston, Lloyd D.. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press, Copyright 2001.

Tengs, Tommy; Osgood, Nathaniel D; Chen, Laurie L. The Cost-Effectiveness of Intensive National School=Based Anti-Tobacco Education: Results from the Tobacco Policy Model. *Preventitive Medicine* 2001: 33(6): 558-70.

Tennant RB. *The American Cigarette Industry: A Study in Economic Analysis and Public Policy.* New Haven (CT): Yale University Press, 1950.

Tobacco Institute. *Tobacco Industry Profile 1997.* Washington: Tobacco Institute, 1997.

Townsend JL, Roderick P, Cooper J. "Cigarette Smoking by Socioeconomic Group, Sex, and Age: Effects of Price, Income, and Health Publicity." *British Medical Journal* 1994; 309 (6959): 923-6.

UK Department of Health. *Effect of Tobacco Advertising on Tobacco Consumption : A Discussion Document Reviewing the Evidence.* London: U.K. Department of Health, Economics and Operational Research Division, 1992.

United States General Accounting Office, "Internet Cigarette Sales", GAO-02-743, August 2002.

Wasserman J, Manning WG, Newhouse JP, Winkler JD. "The Effects of Excise Taxes and Regulations on Cigarette Smoking." *Journal of Health Economics* 1991; 10 (1): 43-64.

Winston GC. "Addiction and Backsliding: a Theory of Compulsive Consumption." *Journal of Economic Behavior and Organization* 1980; 1 (4): 295-324.

APPENDIX B
GLOBAL INSIGHT POPULATION REPORT

(THIS PAGE INTENTIONALLY LEFT BLANK)

A Forecast of Population (2000-2040) for Counties in California including San Diego County

Submitted to:

Tobacco Securitization Authority of Southern California

Prepared by:

Global Insight (USA), Inc.

May 26, 2006

Jim Diffley
Group Managing Director

Heather Upton
Associate

Global Insight, Inc.
800 Baldwin Tower
Eddystone, PA 19022

(610) 490-2642
FAX: (610) 490-2770

Table of Contents

Executive Summary

The US Census measured the population of the state of California at 33,871,648 in 2000. We project that it will reach 51,549,610 in 2040. For the county of San Diego, we project that the population will grow to 3,071,382 in 2010, 3,469,819 in 2020, 3,883,651 in 2030, and 4,340,977 in 2040. This results in a decline in San Diego share's share of the state population to 7.97% in 2010, followed by a rise throughout the rest of the forecast period to 8.09% in 2020, 8.23% in 2030, and 8.42% in 2040.

Global Insight Population Projection

Year	California Population	San Diego Co. Population	San Diego Co. Share of State (%)
2000	33,871,648	2,813,833	8.31%
2010	38,518,314	3,071,382	7.97%
2020	42,869,736	3,469,819	8.09%
2030	47,169,112	3,883,651	8.23%
2040	51,549,610	4,340,977	8.42%

In order to forecast, over forty years, the share of California population that will reside in each of the state's counties, we must understand the determinants of population growth and change both in individual counties and in the state of California as a whole. The US Bureau of the Census projections of fertility and mortality by age, sex, and ethnic group has been applied to the current population of California counties. In addition, Global Insight's economic models of the US, the state of California, and the metropolitan areas of California have been used to project migration to and from California counties. The migration component of demographic change consists of in-migration from abroad, from other US states, and from other California counties; and in the other direction, out-migration to such jurisdictions.

Global Insight projects that the California economy will expand at approximately the same rate as the U.S. average through this decade. We project that California will continue to gain population through migration, but that positive net domestic migration to the state from the rest of the U.S. will cease this decade. In our forecast, international immigration will continue, however, to provide the state with a significant net migration inflow. Thus we project that the state's population will grow at a faster rate than that of the U.S.

Within California, we project that the high costs of living and of doing business in Silicon Valley and the Bay Area will result in the relative movement of jobs and people to the Central Valley areas. In Southern California, a shift in the geographic focus of growth will also occur. We project that the densely settled Southern California counties of Los Angeles and Orange will experience significant outflows of population to Riverside, San Bernardino, and other counties.

The fist half of this decade saw an enormous appreciation in housing prices in San Diego. This growth, while reflective of the desirability of San Diego as a location, also sharply limited its affordability for many. Subsequently it became clear that domestic migration flows had turned sharply negative. That is, many more people were leaving the county than were entering. Net domestic out-migration will continue to be high until some of the housing price differential with other counties in California and elsewhere have shrunk. By 2010, the share of California population in San Diego County will have fallen to less than 8%. Thereafter, however, consistently strong international immigration, a relatively high birthrate (correlated

with San Diego County's ethnically diverse demographic base), and rising life expectancy will sustain an overall rate of population growth significantly higher than the state average. The county will increase its share of California's population from 7.97% in 2010 to 8.42% in 2040.

Our model was constructed from widely accepted economic and demographic principles and Global Insight's long experience in building econometric forecasting models. A review of the economic and demographic research literature indicates that our model is consistent with the prevalent consensus among economists and demographers concerning growth in the population of California. We considered the impact of fertility/birth rates, mortality rates/life expectancy, migration (including international, domestic, and inter-county migration within California), age, gender, and ethnicity, as well as the business cycle, land area and usage, water resources, and environmental risks such as earthquakes. After extensive analysis, we found the following variables to be relevant in building an empirical model of California population through 2040 by county, indicating changes through the period in the county shares of the total population: births, deaths, and migration (international, domestic and county-to-county). The projections and forecasts are based on reasonable assumptions regarding the future paths of these factors.

Disclaimer

The projections and forecasts included in this report, including, but not limited to, regarding the future population of San Diego County, 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, San Diego population inevitably will vary from the projections and forecasts included in this report and the variations may be material and adverse.

INTRODUCTION

The goal of this research is to forecast the share of California's population, over the next forty years, that will reside in San Diego County. In order to do this we must understand the determinants of population growth and change both in San Diego County and in the state of California. We view the problem as having two broad dimensions, one demographic, the other economic.

Population changes for two reasons. The first is demographic and is the natural rate of increase due to a higher number of births than of deaths. The second reason is economic, as economic conditions are the primary determinant of migration flows. The natural increase in population as a result of births to female residents of the state and of San Diego County is a relatively predictable phenomenon. The number of births per female, or the fertility rate, has been extensively studied and documented. It is a function primarily of the age and ethnic composition of the population. Similarly, the predicted number of deaths in a population is described by a mortality rate, which varies most importantly with the age distribution of the population, but also with ethnic and sex characteristics.

We use the cohort component method of population projection to forecast the natural increase in population for each of the counties of the state of California. This method is described in Chapter 1. It is acknowledged by demographers and economists as the most credible methodology in population projection and is the methodology used by the US Bureau of the Census in its population projections for the US.

This methodology generates our forecast of San Diego County's population and its proportion of total California population. In order to accomplish this we began with the base population of each California county, a fully detailed age/race/sex description of the existing population. For instance, we identified, for each single year of age, the number of residents of each sex and ethnic category. These base numbers were the starting points of our projections, and are calibrated to match the tabulation of the 2000 U.S. Census. From this distribution we can predict, with a high degree of confidence, the number of births and deaths in any given year, as we "age" the population one year for each succeeding year. The U.S. Bureau of the Census ("Census") provides projections of fertility and mortality rates by age/sex/race for each year until 2040. The Census projections are the sole source of credible projections for these rates, and we have used them in our modeling.

The second major source of population change, migration, is primarily influenced by economic factors. The economic view is that people, depending upon many factors including their income, occupation, and stage of life, have preferences as to where they would like to reside. Geographical amenities, such as mountains or beaches, are important, as are social and cultural ones. Of course, costs of living vary significantly at varying locations, as do the availability of employment and its remuneration. The latter factors are a function of business location decisions, which are determined by myriad economic factors, and the state and structure of the economy.

There are three types of migration to consider. First, international migration is driven by social, economic, and political conditions in foreign countries relative to those of the US. The decennial Census enumeration does not distinguish between legal and unauthorized immigrants. We use Census projections of immigration to the US by country of origin and the observed distribution of those immigrants among California counties, to project international immigration by county during the forecast period, up to the year 2040.

Second, domestic migration between California and other states, encompassing both in-migration to California and out-migration from California, has been a key factor in explaining California population growth trends. This has been, and will continue to be, a function of relative economic conditions in California versus the rest of the U.S., which can cause business and labor to enter or leave the California economy. Similarly, movement within the counties of California is determined by relative economic and social conditions across the disparate regions and counties of California. In both of these cases of

domestic migration we have extensively examined the county-to-county migration tally of the Internal Revenue Service. Our forecasts of future movements are consistent with Global Insight's U.S., state and metropolitan area economic forecasts. In these models we assume that population and the labor force follow jobs through migration, and that relative rates of economic growth determine local area employment. These projected migration flows are then incorporated into the cohort component methodology in order to incorporate their impact on future births and deaths.

This report is organized as follows: Chapter 1 describes the methodology used to project population by county for 40 years. Chapter 2 describes demographic forecasts for the US. The economic outlook for the nation and the state is presented in Chapter 3. Chapter 4 discusses the population forecast for the state. Chapter 5 discusses San Diego County's economic and population forecast and the forecast of its share of California population. In Chapter 6 we discuss alternative projections and the sensitivity of our analysis.

Chapter 1
Demographic Methodology

Global Insight's population model is designed to forecast the county-by-county population of California from 2000 to 2040, in order to provide the county population shares used in the determination of the payments made to the County under the ARIMOU. We believe that the size of population in the future is best forecast by incorporating all of the changes in the components of population, which are reflected in the actual numbers, such as the number of births, the number of deaths, the number of immigrants, and the number for domestic migration. As a result we have chosen not to forecast the county population share directly, but to forecast the population of each and every county in California and subsequently calculate the county population share. The county population is forecasted by the cohort component method, which is based on the traditional demographic accounting system:

$$Population_t =$$
$$Population_{t-1} + Birth_t - Death_t + Net\ Domestic\ Migration_t + Net\ International\ Migration_t$$

where $t = 2000, \ldots, 2040$.

Each component is forecasted for each age cohort based upon sex and ethnicity. The methodology is outlined below.

Natural Increase

A. Births

The forecast for births by ethnic group uses the national fertility rate by ethnic group projected by the U.S. Census Bureau based on data from the National Center for Health Statistics. The fertility rates are calculated for women aged 10 to 49 years old by the five race and ethnic origin groups for each year from 2000 to 2040. Once the total number of births is calculated by applying the rate to each childbearing age group, 1990–1998 national birth sex ratios are applied by ethnic group to allocate forecast births of males and females.

B. Deaths

The forecast for deaths by sex and ethnic group uses the national mortality rate projected by the U.S. Census Bureau based on data from the National Center for Health Statistics. These mortality rates for the forecasting period are calculated for each sex from 0 to 100 years of age and for five race and ethnic origin groups, at annual frequency from 2000 to 2010 and in five-year increments from 2015 to 2040. The total number of deaths is calculated by applying the rate to each age cohort by sex and ethnicity.

Migration

A. international Migration

International migration to California is projected first and allocated into counties. Since this projection depends on immigration policy, the U.S. Census forecast on immigration is taken as a benchmark. The state forecast for immigration is calculated using the historical proportion of immigrants to California out of total U.S. immigrants. Historically, immigration has been a relatively stable component of population change; during the 1990s the annual inflow to California varied between 201,253 and 288,553, a difference of 0.03% of state population. Once the state forecast is calculated, the historical proportion of immigrants to each county relative to the state is applied to allocate the number of immigrants to counties. To keep the cohort component method, this county figure is allocated into ethnic groups by sex and age. The historical ethnic group proportions for each county and the historical age distribution of immigrants to the state are used for this allocation.

B. Domestic Migration

Domestic migration is the most volatile component because it depends on economic trends and regional development. The California state population forecasts by the U.S. Census, the California Department of Finance, the UCLA Anderson Forecast, and the Center for Continuing Study of the California Economy deviate from each other, mostly because they have different forecast models for this component.

Our forecast uses Global Insight's State and Metropolitan Area macroeconomic forecasts and the IRS migration data collected from tax returns to forecast domestic migration. First, the size of state migration is forecast. This provides the benchmark for the sum of counties' net domestic migration annually. Second, forecasted relative rates of metropolitan area economic growth are combined with historical IRS county-to-county migration data to allocate domestic migration across the counties. In addition, adjustments are made based on qualitative judgments of Global Insight analysts.

The IRS migration data is collected by comparing the Social Security number of individual tax returns for two consecutive years. The IRS data contains the number of residents migrating from one county to another. It provides the historical benchmarks of the distribution across counties of migration flows to which we apply our economic forecasts of future migration.

The age distribution catches the characteristics of county-to-county migration. The counties that have the UC educational institutions, for example Los Angeles County, San Diego County, and Alameda County, have in-migration for the age group in the late teens, representing incoming college students, but out-migration for the age group in the early twenties, driven by students graduating and moving away. This relative pattern is kept even in the period of out-migration, i.e., relatively small out-migration in absolute value for the late-teens age group, and large out-migration in absolute value for the early-twenties age group.

Chapter 2
US Population and Demographics

The US population is projected by the Bureau of the Census to expand at an annual rate of 0.8% between 2000 and 2020, with the rate of increase then slowing to near 0.6% per year by 2040. The population growth rate rose as the baby boomers passed through their prime childbearing years, producing an "echo" of the post-war baby boom. Births peaked in 1988, at 4.4 million, matching the previous highs of the late 1950s and early 1960s.

Increasing life expectancy and high net immigration are key factors in the expansion of the population. The mortality rates contained in the Census forecast reflect ongoing improvements in health care, nutrition, and general living standards. Life expectancy is projected to rise throughout the forecast period for both men and women. Death rates rise slightly over the forecast period. This is entirely the result of the aging population, as survival rates at every age rise over the forecast horizon. Relatively low fertility rates (compared to historical experience) and high immigration dictate that a rising share of the U.S. population will consist of persons born abroad.

Results of the 2000 census put the unadjusted U.S. population at 281,421,906. As anticipated, the Mountain states region led all regions in growth by a wide margin. This region's 33.0% increase since 1990 is almost triple the U.S. rate of 13.2%. The primary reason is domestic migration from other regions, though a relatively youthful population in the Mountain states also leads to higher birth and lower death rates than the U.S. average. Population growth in the Pacific region, consisting of California, Washington, Oregon, Alaska, and Hawaii, at 15.1%, also exceeded the U.S. average. The Northeast and Midwest regions grew at rates below the average, with the Northeast states trailing the other regions at just 5.5% growth for the decade.

The 2000 results were generally consistent with trends through the 1990s, though California and Massachusetts have seen significant turnarounds from sluggish growth earlier in the decade. Georgia was the fastest growing state outside the Mountain region, while Minnesota was the fastest growing Midwestern state. Although a few states such as Hawaii, North Dakota, and Pennsylvania posted occasional year-to-year net losses in population during the 1990s, every state's population rose, at least mildly, during the decade as a whole.

These trends are a continuation of the very long-term shift in U.S. population towards the South and West. The migration became noticeable with the decline of Rust Belt manufacturing, but has, in fact, been ongoing since World War II. The major domestic migration flows from 2000 to 2004 were outflows of 900,000 from the Middle Atlantic and 550,000 from the East North Central region, and inflows of 1,350,000 to the South Atlantic and 600,000 to the Mountain states. Among states, the largest net gainers from domestic migration were, in order, Florida, Arizona, Nevada, Georgia, North Carolina, and Texas. The largest losers were New York, California, and Illinois.

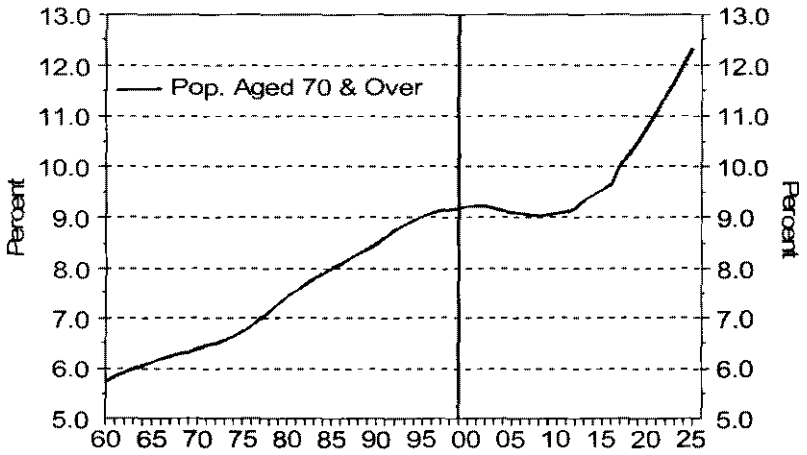
International migration, on the other hand, is dominated by a different set of states. Of U.S. net migration of 5.3 million from 200 to 2004, gains of 1,200,000 occurred in California, and New York, Texas, while Florida accounted for another 1.600,000. In California's case, it more than offset domestic out-migration of 415,000. Prior to California's economic recovery in the late 1990s, its domestic outflow had been much greater. In New York, foreign immigration offset part of a domestic outflow of 770,000.

Through the end of this decade, Global Insight expects the Mountain region to continue adding to its population more quickly than any other region in the U.S. The Mountain states' population is projected to reach 20 million in 2009. This will reflect a 17% increase in population over the decade, far outpacing the South Atlantic region, for which the corresponding cumulative increase is projected to be 12%. The Pacific region is projected to grow more slowly than either the Mountain or South Atlantic regions, even though the Pacific region is forecast to have the second largest regional population by 2010.

Population growth will not be distributed evenly over all of the age cohorts. The proportion of the population age 70 and over has risen rapidly, from less than 3.0% in 1900, to 5.8% in 1960 and 8.5% in 1990. This proportion will remain in the 9.0% range through 2015, and then rise to 12.3% by 2025. (See Figure 1.) The 16-to-65 age group (the working-age years) will grow at an average annual rate of 0.5% from 1999 to 2025, while the 65-and-over age group will display a more rapid growth rate of 2.4% over the same period. The population is gradually aging as the nation adjusts to a lower-than-historically-experienced fertility rate.

FIGURE 1

Proportion of Population Aged 70 & Over



Birth Rates:

Consistent with Census projections, the number of births in the United States is projected to increase progressively throughout the projection period. The Asian and Hispanic-origin populations are expected to experience the most dramatic increase in the number of births. The non-Hispanic white share of births is projected to decrease throughout the 21st century; all other groups will increase their share of births. By the middle of the 21st century, two of every five births are expected to be non-Hispanic white, one in three will be Hispanic, one in five will be black, and one in 11 will be Asian.

Projected birth rates are calculated using the Census Bureau fertility rates. The Census Bureau states that the "total fertility rate for the United States has remained fairly constant since 1989. As of 1997, the total fertility rate was 2,032.5 births per 1,000 women,"[1] where the total fertility rate (2.03) represents the average number of children that each woman would bear in her lifetime. The Census Bureau bases their fertility assumptions on demographic theory, analyzed past and current national and international fertility trends, and input from data on birth expectations from a national survey.[2] However, as birth expectations data for non-Hispanic American Indians and non-Hispanic Asian and Pacific Islanders are deficient, the Census Bureau has assumed that they will converge to a total fertility rate of 2,100 per 1,000 women (2.1) by the year 2025. Short-term fertility assumptions include non-Hispanic American Indian and non-Hispanic Asian and Pacific Islander total fertility rates declining by .006 and .002, respectively, from 1998 through 2025. Long-term fertility projections incorporate the assumption that rates for each race and

[1] *Source*: Hollmann, Frederick W.; Mulder, Tammany J.; Kallan, Jeffrey E.; US Census Bureau, *Methodology and Assumptions for the Population Projections of the United States: 1999 to 2100.*

[2] Ibid.

Hispanic origin category will move downward toward the "replacement level," reaching 2.1 in 2150. "However, the rate[s] of increase or decrease to the total fertility rates differ among the five race and Hispanic origin groups."[3] These fertility rates, cited in Table 1, form the basis for the Global Insight forecast.

Table 1: Projected Total Fertility by Race & Hispanic Origin per 1000 Women

Race and Hispanic Origin	1999	2025	2050	2100
Total Fertility Rate	2047.5	2206.8	2219.0	2182.9
White, Non-Hispanic	1833.0	2030.0	2043.3	2070.0
Black, Non-Hispanic	2078.4	2120.0	2113.3	2100.0
American Indian, Non-Hispanic	2420.6	2270.0	2233.3	2160.0
Asian, Non-Hispanic	2229.0	2171.2	2154.5	2121.2
Hispanic Origin	2920.5	2677.3	2562.8	2333.8
White	2009.5	2210.2	2230.1	2198.0
Black	2121.9	2164.1	2159.1	2131.0
American Indian	2506.6	2366.3	2329.4	2224.3
Asian	2277.4	2205.8	2180.8	2134.7

Source: Hollmann, Frederick W.; Mulder, Tammany J.; Kallan, Jeffrey E.; US Census Bureau, *Methodology and Assumptions for the Population Projections of the United States: 1999 to 2100.* (Middle Series)

Fertility trends for all race and Hispanic origin groups are as follows: non-Hispanic black fertility rates have declined since 1993 and have converged towards non-Hispanic white rates, while the Hispanic and Asian-Pacific Islander groups have generally maintained higher fertility rates. The latter groups are comprised largely of foreign-born populations that generally sustain higher fertility rates than native women of the same race and origin.

In addition to the general and total fertility rates the Census Bureau publishes, the Census Bureau has further broken down fertility rates to be age- and race-specific. For the purposes of this Global Insight population projection, Census Bureau age- and race-specific fertility rate projections were used. The Census Bureau has derived fertility rates for women of four racial groups (Asian and Pacific Islander, Black, American Indian and Aleut, and White) and with or without Hispanic origin. (As with all fertility rate estimates, these figures are given for women between the ages of 10 and 49, those years in which women are deemed able to give birth). This differentiation of fertility rates according to race and Hispanic background reflects the influences of cultural background, including desired family size, which in turn influence fertility rates. Accordingly, the Census Bureau estimates that the fertility rate for a 30 year-old anywhere in the U.S. varied according to race and Hispanic origin. This variance in fertility rates with regard to race and Hispanic origin is extremely important in calculating fertility rates across the nation, but has particularly great implications in the case of California.

California has a vastly diverse ethnic and racial make-up, due in large part to the steady stream of immigrants entering the state. As the percentage of the non-Hispanic white population decreases, the percentage of other racial and ethnic groups will increase. Thus, California's population is likely to grow,

[3] Ibid.

at least initially, more rapidly than the population of the U.S. overall, because the percent share in the state population comprised of racial groups with higher fertility rates is greater than these groups' relative population share nationwide. This increased birth rate coincides with the remarkable racial diversity in this geographical area, a diversity based to a considerable degree on immigration. It has been found that immigrants maintain the characteristics of their native culture upon entering the United States.

Mortality Rates:

Global Insight used Census Bureau mortality rates that are, like the fertility rates, age- and race-specific. In general, the Census Bureau reports that at present significant mortality differentials exist between males and females and between race and ethnic groups. Data on birth rates and life expectancy exist for whites and blacks. However, for other race and ethnic groups, data are too scarce to identify trends over time. (See Table 2.) Throughout the 20th century, differentials in life expectancy between males and females, and between blacks and whites, have been quite irregular, increasing in some periods and decreasing in others. During the 1990s, the differentials between males and females, and between blacks and whites, have tended to narrow. By 1997, life expectancies for males and females had reached 73.6 and 79.4 years, respectively.[4]

Table 2

Projected Life Expectancy at Birth by Race and Hispanic Origin, 1999 to 2100

(Middle Series)*

Race and Hispanic Origin	1999	2025	2050	2100
Total Population (Male)	74.1	77.6	81.2	88.0
Total Population (Female)	79.8	83.6	86.7	92.3
White, Non-Hispanic (Male)	74.7	77.8	81.1	87.6
White, Non-Hispanic (Female)	80.1	83.6	86.4	91.8
Black, Non-Hispanic (Male)	68.4	73.6	78.5	86.9
Black, Non-Hispanic (Female)	75.1	80.5	84.6	91.5
American Indian, Non-Hispanic (Male)	72.9	78.4	82.2	88.5
American Indian, Non-Hispanic (Female)	82.0	86.5	89.2	93.6
Asian, Non-Hispanic (Male)	80.9	82.4	84.8	89.4
Asian, Non-Hispanic (Female)	86.5	87.7	89.7	93.4
Hispanic Origin (Male)	77.2	80.0	83.0	88.6
Hispanic Origin (Female)	83.7	86.1	88.4	92.9

*US Census Bureau designation that represents the population breakdown according to current trends

[4] *Ibid.*

Chapter 3
Economic Outlook

US Economic Overview

The U.S. economy is now in a period of moderate expansion. Real GDP growth is projected to average 3.4% per year from 2005 through 2009—down from 3.9% annual gains from 1995 to 2000. Over the long-term period of 2005-2040, real GDP growth is forecast to average 2.9% annually, about the same rate as the average of the past 25 years. The economy's underlying growth will slow after 2011, as baby boomers begin to retire, slowing labor force growth. Greater business fixed investment and R&D spending will offset the slowdown in labor force growth, but eventually the effects of weaker labor force growth will become dominant and self-perpetuating. As output growth drops off, business fixed investment rises more slowly, limiting capital stock growth and thus future output gains. Slower long-term increases in the labor force indicate more moderate long-term employment growth. Total civilian employment will rise at an average annual rate of 0.9% from 2004 to 2040. Manufacturing's share of total employment will continue to decline over the forecast period, falling to less than 7% by 2040, from 10.9% in 2004. Global Insight projects that Core Consumer Price Index inflation (which excludes food and energy) will average 2.6% from 2004 to 2040, significantly less than the 4.4% average from 1977–2003. The Consumer Price Index itself, a broader measure of inflation, should average 2.4% per year.

Pacific Region

The Pacific region (PR), consisting of California, Alaska, Hawaii, Washington, and Oregon, was a national leader in job growth in the late 1990's, and in 2000, the region maintained its status with a 3.2% employment gain, well outpacing the South Atlantic (2.7%) and West South Central (2.5%) regions, and behind only the Mountain region (3.4%). The PR's largest state economy, California, was a powerhouse of job growth, with 74% of all the non-agricultural jobs in the region located within its borders. In 2001, however, came the tech bust, and California was hit hard. The PR's job growth slowed abruptly to 0.5% in 2001, and plunged into contraction in 2002, as cities like San Jose, San Francisco, Seattle, and Portland lost scores of jobs. Both the California and the Oregon state economies remained in contraction until 2003, and this hampered the region's struggle to regain positive employment growth. By 2004, an economic resurgence was well underway both nationally and within the region, and job gains became solidly positive again (1.2% in 2004).

The Pacific region's heyday may have passed, at least in the near term, but it will continue to thrive economically. Through 2010, the region will average 1.3% annual job growth, a very solid performance, though the spotlight has now shifted to the Mountain (2.2% average growth through 2010), South Atlantic (1.6%), and West South Central (1.5%) regions. These regions are currently drawing residents and businesses at an incredible rate, due to their low costs and good quality of life. In fact, nearby states like Nevada have made boldly public attempts to woo California businesses and residents, and the state may be forced to take a look, in the near future, at its reputation for having a poor business climate.

California:

As mentioned above, California's powerhouse economy hit a wall in 2001. The crisis in the tech sector plunged the state into three years of negligible employment growth, which in turn affected growth in the region. Since mid-2003, the state has been in rebound mode; annual employment growth registered 1.2% in 2004, and gains have been accelerating since then. But California is no longer the driving economic force of the Pacific Census Region. Employment in the Golden State was 1.6% in 2005, compared to Alaska (1.7%), Washington (2.4%), Hawaii (2.8%), and Oregon (3.4%). We expect that trend will continue, as California, which was the region's growth leader in 1995-2000, moves to the bottom of the pack in the region over the next five years.

Yet despite the tech bust, the electricity crisis, the threat of wildfires and other setbacks, California's economy is healthy, though it is expanding much more slowly than five years ago. Construction and services, which are generating the fastest job growth and largest number of new jobs, respectively, have been the brightest parts of California's employment picture over the past few years. Residential real estate in 2004 in California hit both record highs and record lows: home sales and the median home price reached record high levels, while supply conditions and their share of first-time buyers in the California housing market fell to historic lows. New housing starts declined slightly in 2005 and home price appreciation moderated in the coastal metro areas. All of these signals point to a softening real estate market.

Table 3

Employment Growth: California and the Pacific Region

State/Region	Employment Annual Growth % 1995-2000	Employment Annual Growth % 2005-2010
Pacific Region	2.8	1.4
Alaska	1.5	1.2
California	**3.0**	**1.3**
Hawaii	0.5	1.8
Oregon	2.8	1.7
Washington	2.8	1.4

In terms of exports, California was knocked out of the number-one spot in 2002, as the Golden State's high-tech slump and West Coast port shutdown allowed Texas to push ahead. To date, the positions are unchanged. In 2005, California exported $109.9 billion in goods, 13.5% of all U.S. exports—still not back to its 15% share in 2000. High-technology goods exports (computers and electronic products) totaling $42 billion were shipped in 2004, up 15% from 2003 shipments, and high-tech goods accounted for 38% of California's exports in 2004. Texas, the next largest high-tech exporter, shipped $31 billion in high-tech products in 2004, though the composition was only 27% of the state's total exports. Export-supported jobs account for an estimated 8.6% of California's total private-sector employment in 2004, significantly larger than the national average of 6.5%.

California's job growth remains uneven in both sectoral and geographic terms. Despite the bursting of the tech bubble, the San Francisco Bay Area and Southern California's metropolitan cluster still drive the state's growth, while the more rural southern Central Valley continues to struggle to overcome its high unemployment rates—partially due to the seasonality of agricultural work. Although the boom years are past, California's economy will perform solidly over the next five years. California nonagricultural employment is expected to grow by 1.1% overall from 2005 to 2010, while the U.S. job total, reflecting a slightly faster rate of increase, will rise by a projected 1.2% during the same period.

Professional and business services will dominate the state's job growth over the next five years, expanding by an average of 2.3% annually. Only small sectors that do not employ nearly the same numbers, such as transportation and warehousing, will grow at similarly high and sustained rates. Lagging sectors over the next five years include finance (-0.2%) and manufacturing (-0.1%), which continues its long-term decline. Population and employment gains will create 5.3% personal income growth over the next five years.

In the long term (2010 through 2040), we project the California economy will cede its position as a major growth leader and converge with the rest of the United States in terms of population growth, employment growth, unemployment rates, and income and wages. As will be the case in much of the nation, the state's manufacturing sector will endure a slow decline, while services industries will further consolidate their already established position as a driver of growth. In the very long term, California's concentration of high-tech companies will be a boon for the state's economy; the tech sector's short-term volatility will be offset by its future gains.

Metropolitan Area Outlook

Table 4 presents our outlook for employment in the California metro areas. As mentioned above, growth in the state will slow through the end of the decade, and the variance of growth across metros will flatten as well. In the 1990s, the San Francisco Bay area led the state in economic gains, and Silicon Valley's high-technology leadership propelled much of US economic growth. This success created business and housing cost pressures that encouraged growth in the surrounding region, a trend that has continued despite the bursting of the tech bubble and downturns within the San Francisco and San Jose metro areas themselves. For this reason we forecast strong growth this decade in the Sacramento, Stockton and Vallejo metro areas.

The Southern California metro areas also saw robust growth in the 1990s driven by their high-tech sectors, although they are also renowned for naval and commercial seaports, and aerospace, electronics, and industrial machinery manufacturing. An increasing numbers of workers are choosing to move out of the coastal Southern California metros, however, and commute from adjoining inland counties. Therefore, in the coming years, employment growth will be particularly robust in Riverside, which accommodates much of the spillover growth from the highly congested region to its west, and will consequently also witness some of the state's most rapid population growth. We project that employment in San Diego County will increase through the forecast period at a slightly better pace (1.6%) compared to job growth statewide (1.4%).

Table 4

California Metropolitan Area Outlook

Metro	Employment Annual Growth % 2005-2040
California	**1.4**
Bakersfield	1.3
Chico	1.2
Fresno	1.5
Los Angeles-L. Beach	0.5
Merced	1.5
Modesto	1.5
Oxnard-Ventura	1.4
Riverside	2.5
Sacramento	1.8
Salinas	1.1
San Diego	**1.6**
San Fran-Oakland	1.0
San Jose	1.2
Santa Barbara	0.8
Santa Cruz	1.0
Santa Rosa	1.2
Stockton	1.8
Vallejo	1.5
Visalia	1.4
Yuba City	1.3

Chapter 4
California Population

California, located on the Pacific Coast of the United States, received little attention from Europeans for more than three centuries after its first sighting in 1542. Following the establishment of missions late in the 1760s, the first organized group of settlers arrived in 1841 by wagon train from Missouri. Shortly thereafter, the discovery of gold caused immediate, extensive population growth, and in 1850 California became the 31st state. Population growth and immigration have continued to be trademarks of the state since it joined the union. Between 1860 and 1960, the population almost doubled approximately every twenty years. By 1970, California had become the most populous state in the nation, home to almost 20 million persons. In the 30 years through the end of the century, the state gained half again as many residents as it had in 1970. The U.S. Census Bureau recorded California's population at 29,760,021 in 1990 and at 33,871,648 in 2000, for a 10-year gain of 13.8%. This slightly outpaced the corresponding nationwide increase of 13.2%. The Golden State now accounts for 12% of U.S. inhabitants. Although California has been the most populous state for a short segment of U.S. history, 2000 Census figures show that its population now outnumbers the second-place state, Texas, by more than 15 million. The 2000 Census counted 11,502,870 households in California. Estimates by the Census Bureau for 2005 indicate that thus far this decade, California growth of 6.7% since 2000 exceeds the U.S. increase of 5.3%. (On December 22, 2005, the Bureau estimated that the state population was 36,142,147 in 2005.)

According to the U.S. Census, total California population grew by 4,111,627 between 1990 and 2000. More than half this increase occurred in the five large jurisdictions of Los Angeles, Orange, San Diego, Riverside, and San Bernardino counties. Six other counties—Fresno, Santa Clara, Sacramento, Alameda, Contra Costa, and Kern—also each added more than 100,000 people during the decade. From 2000 to 2005 the Census Bureau estimates that the state added over 2 million residents.

An important factor affecting the growing California population is the land capacity of the state. Is there enough land in the state to support the growing population? Without an adequate supply of serviced and developable land, the most basic of new housing factors, it is impossible for homebuilders to build new homes. According to the California Department of Housing and Community Development, as of 1996, land in 35 (of the 58) California counties for which detailed land supply data are available indicate that approximately 3.5 million acres of urbanized land, 32 million acres of public or undevelopable land, and nearly 25 million acres of physically-developable land exists. However, upon closer examination, the latter 25 million acres could not all be "realistically" developed. Excluding land for environmental or other reasons would drastically diminish available developable land in the state. Excluding wetlands and prime and unique farmlands, floodzones, special areas identified by the California Department of Fish and Game, and sites with an Endangered Species Index of 40 or more would reduce developable land supplies to 8.2 million acres. Furthermore, with this reduction in available land, coupled with high density and growth areas, the Department of Housing and Community Development estimated that Los Angeles and Orange counties will run short of developable land between 2010 and 2020.[5]

There may, of course, be other natural-resource related constraints that can impinge upon population growth in particular regions. Water resources availability has long been a focus of public policy in California. We have not incorporated any relative changes in the availability of water across the state. We assume that water capacity will continue to direct development as it has in the past. To the extent that California agriculture is substantially irrigation-based, while soil salination and market factors are likely to reduce the state's extent of irrigated cropland, the conversion of available land from agriculture to other

[5] *Source*: California Department of Housing and Community Development: *Report: Raising the Roof—California Housing Development Projections and Constraints 1997-2020.* http://www.hcd.ca.gov/hpd/hrc/rtr/index.htm.

uses may in some circumstances allow the redirection of water supplies currently in place to new nonagricultural consumers.

In regard to another well publicized issue, much public policy discussion about urban sprawl has occurred in recent years. We assume that prospective new laws and regulations relating to land use and development will not alter the relative population distribution at the county level.

Births and Deaths

The fertility and mortality rates in California vary with both the age and racial composition of the population. Our forecast applies the Census fertility and mortality projections by age, sex, and ethnicity to the California population base.

Migration to California

Migration has had a huge impact on the culture and economy of California, increasing population dramatically. In the forty-year period ending in 1985, substantial numbers of foreign and domestic migrants arrived in California. Total net migration into California trended upwards from 1970 until it peaked in 1988. That year saw record net migration with a positive balance of 420,120 persons moving into the state. Total net migration fell with the recession of the early 1990s. It turned negative in 1992 (as more people left the state than arrived), with a net balance of 23,450 departing California that year. This trend continued, reaching its nadir in 1994 when out-migration accounted for a net of 181,110 persons exiting the state.

For much of the 1990s the continued sizable net inflow of population from foreign countries only partly offset large-scale net out-migration of Californians to other states. The robust economy in the second half of the decade spurred a reversal in this trend, as domestic and foreign in-migration once again became positive in California. The next business cycle, the 2001 recession and the burst of the high technology bubble, predictably impacted migration flows. The state lost a net 415,000 residents from 2000 to 2004 to other states, though it added 1.2 million foreign immigrants.

Migration consists of two components: domestic and international migration. Domestic migration, migration between California and the rest of the United States, has had less of an influence on the population of the state than international migration, those immigrants from outside the U.S...

California attracts more foreign immigrants than any other state, and disproportionately more than would simply line up with its status as the nation's most populous state. Immigration, including illegal immigration, has become the largest component of California population growth. Prior to the 1970s swell in immigration, domestic migration drove California population trends. International immigration accounted for less than 10% of the state's population growth from 1940 to 1970. Since 1970, it has accounted for almost 50%.

International immigrants have settled unevenly in California, with Los Angeles County acting as the state's largest magnet for the immigrant population. In 1960, one-tenth of Los Angeles residents were immigrants; by 1990 the share had risen to one-third. This huge upswing in immigrants has also changed the age profile of the state. In 1960, the state reflected the age profile of the United States; by 1990, the state had a much younger population than the rest of the U.S., with decidedly more young workers and fewer retirees. This younger labor force, to a significant degree the outcome of widespread immigration, has contributed to the disproportionate economic growth California has experienced compared to the rest of the nation. Immigrants have acted as a low-cost labor resource, as California natives have consistently been shown to out-earn non-natives. California's large immigrant population has enabled the state's employers to benefit from a fall in labor costs relative to employers in other U.S. states.

California has the largest populations of Spanish-speaking people, American Indians, Chinese, Filipinos, Japanese, Koreans, and Vietnamese in the U.S., as well as the second-largest populations of blacks and Asian Indians in the fifty states. The Golden State's ethnic diversity has grown in the last quarter century, with the array of its racial composition broadening much more quickly than that in the rest of the nation. To compare, once again, the diversity of the national and California populations in 1970 and 1990: in 1970, both the state and national populations were approximately 20% minorities; in 1990, a 25% contingent of the U.S. population was minorities, whereas almost half of the California population was minorities. The composition of the immigrant flow consists primarily of Mexicans and Central Americans, as well as Asians. On average, immigrants to California as well as to the U.S. in general have a lower level of educational attainment than native-born Americans.

Intra-California Migration

County-to-county migration will be the focus of our examination of population movement within the state of California. As in many areas of the nation, county-to-county migration in California displays a trend of out-migration from urban counties to neighboring suburban counties. However, in California, as the distances between urban and suburban areas increase or decrease with the growing population, urban areas are stretching further and further within counties. As the cost of living rises in urban areas, Global Insight projects that more out-migration to neighboring counties will take place. However, a backlash against increased transportation time and other factors related to extensive suburban development is also apparent, so that large-scale out-migration will simultaneously give rise to movement back into the urban counties, i.e., intra-county and inter-county migration flows back into urban areas from more distant suburbs.

Forecast

Based on information through 2005 we forecast that California population will increase to 51,549.610 by 2040. This represents a compound annual rate of growth of 1.06% since 2000. The growth rate is however, declining over time, from 1.29% in the current decade, to 0.89% from 2030 to 2040. San Diego County population growth will average 1.09%. The compound annual rate of growth this decade will be 0.88%, and will increase 1.23% from 2010 to 2020, followed by slowing to a 1.12% rate for 2030 to 2040. Among the counties of the greater San Francisco Bay Area, we project that only Contra Costa, Napa, and Sonoma will attract net domestic migration. We project that the densely settled Southern California counties of Los Angeles and Orange will experience significant outflows of population to Riverside, San Bernardino, and other counties. International immigration will continue to boost growth in Southern California and in the Central Valley counties. And the generally younger populations in the Central Valley will result in higher rates of natural population increase there going forward.

Chapter 5
San Diego County Outlook

The county of San Diego is the third-largest in the state, behind only Los Angeles and Orange Counties in terms of population. The margin of difference between Los Angeles and the next-largest counties, however, is considerable. The US Census Bureau estimated the 2005 population of Los Angeles County at 9,935,475, more than triple the corresponding figure for the counties of Orange, at 2,988,072 and San Diego, at 2,933,462. While Orange County, located on the coast between San Diego County to the south and Los Angeles County to the north, has a slightly greater population than San Diego, it is geographically smaller and more intensively developed. Thus the potential for sustained robust demographic growth rates is slightly greater in San Diego County, although, as we will discuss below, San Diego faces other constraints.

All the large metropolitan counties of Southern California share an important factor bolstering their historic and projected population growth: international immigration. In San Diego's case, the county directly borders Mexico, augmenting San Diego's County's role, though it is certainly shared by the entire region, as a magnet for legal as well as illegal immigration from Mexico and elsewhere in Latin America. San Diego County and the general Southern California area also serve as a gateway for trans-Pacific immigration. The Asian-Pacific Islander group is the second-largest ethnic minority in San Diego County, behind Hispanics, though the number of Hispanics is about three times larger. Ongoing ethnic diversification through immigration and natural increase among recent immigrant groups, as can be observed in San Diego County and adjoining areas of Southern California, assures that the region will continue to experience population gains, regardless of the fluctuations in domestic migration. The birth rate tends to be higher in immigrant communities than among those who have been in the US for generations.

San Diego's economy is another reason behind the county's population growth. The county, like the state, has undergone an economic transformation during the last decade and a half. In fact, the evolution of a cutting-edge economy based on information, life sciences, and services has progressed farther in San Diego than in most other jurisdictions, particularly in Southern California.

During the late 1980s, San Diego's considerable prosperity was somewhat narrowly based, with a large component of defense industry activity. By the end of that decade, especially after the dissolution of the Soviet Union and the end of the Cold War, federal policy was committed to streamlining and downsizing defense procurement, and military spending was substantially reduced. This, in conjunction with the nationwide recession in 1990-91, had a crippling effect on the San Diego County economy. The same can be said for nearby areas, including Los Angeles and Orange counties, where large defense-related sectors also underwent major cutbacks in the late 1980s and early 1990s. However, by nearly all measures, the economic reconfiguration of San Diego has outpaced the transition process in most of the rest of Southern California. Today, San Diego has become a leader in telecommunications, electronics, computers, software, and biotechnology—an emergence in which the presence of the educated, high-tech-ready labor force that originally located in the area to work in defense-related industries has played a leading role.

Drawing on high-skilled labor cultivated by the local defense industry, the region's communications agglomeration has steadily developed as industry suppliers have migrated to the area. High-level research programs at universities and other institutes in the region, such as the University of California at San Diego and Scripps Institution of Oceanography, have supported the area's transformation to a high-tech economy by providing access to the most sophisticated knowledge and fostering the availability of a top-quality workforce.

Biotechnology has also been strongly supported by regional universities and institutes, and San Diego remains an important global player in this field. By almost any measure, San Diego's biotech cluster ranks

among the topmost in the United States; indeed, a 2004 Milken Institute report ranked San Diego the number one metro area in the US in biotechnology.[6] The study found that San Diego's life sciences industry is directly and indirectly responsible for 55,600 jobs and $5.8 billion in income—5.3% of output—in the metro area. The region is excels in innovation and R&D, as well as in translating ideas to the marketplace, and San Diego is one of only a handful of metropolitan areas that have succeeded on a scale necessary to ensure industry sustainability. The Milken Institute has stated that San Diego "has one of the broadest and most balanced arrays of technology clusters of any metropolitan area in the US. In addition to being labeled as 'Biotech Beach,' the region is also known as 'Telecom Valley' and the 'Wireless Communications Capital of the World.' "[7]

San Diego's economy is driven by its non-manufacturing sector, which accounts for over 90% of non-agricultural employment. As of December 2005, total non-farm employment was 1,287,400, of which manufacturing jobs, at 103,400, represented only 8% of the total, compared to a US-wide average of slightly under 14%. This figure is down from 129,710 manufacturing jobs in December 2000, when the sector represented 11% of total employment. Historically, local economic development officials have cited low unskilled wage rates—a factor linked to the large immigrant population—as an inducement for manufacturing industries to locate in the area. However, other costs of doing business have risen rapidly. Some—notably rising land and housing costs—are a direct effect of the boom conditions seen in San Diego during the last decade. Others, such as higher transportation and utility costs, stem from external factors. As a result, the prospects for expansion in manufacturing in San Diego County, particularly low value-added manufacturing, are likely to be limited. The share of manufacturing in local employment, and quite possibly the absolute total of manufacturing jobs, are likely to continue to drop in the near future.

Services is San Diego's largest sector, representing 37% of non-manufacturing employment or some 537,000 jobs as of December 2005. Tourism is one of the pillars of the local economy; more than 14 million tourists each year visit the area's attractions, including Sea World, the Wild Animal Park, the San Diego Zoo, Mission Bay, and Cabrillo National Monument. Trade and transportation jobs are another big employer; jobs in the trade, transportation and utilities category total about 220,000 in the metro area. Government employs 214,000, a total boosted significantly by the presence of major Navy and Marine installations on the coast. The concentration of military activity is always vulnerable to the prospect of defense consolidation and downsizing, but a renewed flow of defense dollars to San Diego contractors assures the future of several major employers, at least for the time being. According to the San Diego Regional Chamber of Commerce's Economic Research Bureau, total defense revenues in San Diego in fiscal 2003 grew 26.7% to $13.4 billion.

Despite the fact that San Diego has become one of the state's largest and most vibrant urban areas, its agricultural sector remains important. Over 10,000 persons were employed in agriculture in San Diego as of December 2005, although that number is down from nearly 16,000 in 1998. San Diego County is the 20th largest agricultural producer in the nation, and is a top producer of nursery products, flowers, foliage plants, and avocados.

San Diego at present displays a significantly tighter labor market, as indicated by its unemployment rate, than either the state or the nation on average. In December 2005, the San Diego metro area posted an unemployment rate of 4.1%, compared to 5.1% in California as a whole and 5% on average throughout the US. The San Diego MSA's low jobless rate also stood out among jurisdictions in the Southern California region. While adjacent Santa Ana (Orange County), at 3.5%, recorded an even lower December 2005 figure than San Diego County, unemployment rates in other Southern California metro areas were higher: Los Angeles at 5.5%, Oxnard-Ventura at 4.3%, and Riverside-San Bernardino at 4.8%.

---

[6] *Source:* Milken Institute, *America's Biotech and Life Science Clusters: San Diego's Position and Economic Contributions*, June 2004. http://www.milkeninstitute.org/

[7] *Source:* San Diego Regional Economic Development Corporation. http://www.sandiegobusiness.org

Although there are is the ongoing risk of economic disruption due to supply and infrastructure issues related to both water and utilities, we believe that these matters are currently being resolved, as the region and state expand and improve the electricity and water infrastructure. To a significant degree, California's sharp economic inflection point in the mid-1990s, when the state suddenly shifted from being one of the weakest-performing state economies in the US to one of the nation's strongest, caught planners unaware. The need, and market, for further infrastructure development are now evidently present, and such development has indeed begun to occur. Although a lag of up to several more years is inevitable before planned improvements come on line, current constraints should not have a decisive impact on the long-term forecast.

The most pressing issue for San Diego is the cost of housing. The California Department of Housing and Community Development's February 2006 report asserted that the state is facing a housing crisis.[8] The problem is due in part to high demand and low supply, and in part to skyrocketing housing costs, and these are particularly at issue in San Diego. In the fourth quarter of 2005, the Office of Federal Housing Enterprise Oversight (OFHEO) found that the San Diego-Carlsbad-San Marcos metropolitan area registered a five-year home price appreciation rate of 114.5%.[9] This appreciation rate was the 36th fastest among the 275 US metropolitan statistical areas charted by the OFHEO. Indeed, the California Association of Realtors found that in December 2005, less than 10% of households in San Diego County were able to afford a median priced home. That ranked San Diego as one of the five least affordable counties in the state, on par with Mendocino, Sonoma, Napa, and Santa Barbara.[10]

Quickly rising home prices have begun to make San Diego a less desirable place to live. In 2005, for the first time since the earthquake of 1803, San Diego lost population. Given the area's beautiful weather, strong economy, and good quality of life, we attribute this decline in population directly to affordability. Fortunately, home price appreciation has been softening of its own accord; the San Diego-Carlsbad-San Marcos metropolitan area registered a year-over-year increase in home price appreciation of 11.1% in the fourth quarter of 2005, nearly two percentage points lower than the US average of 13%. This is down sharply from the metro's peak appreciation rate of 31.1% in the third quarter of 2004. We expect weaker home price appreciation will reverse the negative population trends, although affordability will continue to be a near-term issue for San Diego.

Population

San Diego County has mirrored state growth, both demographically and economically. The demographic composition of San Diego County has changed over the last generation. The percentage of non-Hispanic whites had declined, the African American and Native American (American Indian) percentages of the population have remained static, while and the shares of both the Asian-Pacific Islander and Hispanic populations have grown. This pattern of shift in the ethnic make-up of San Diego County's population will continue, characterized by increasing diversity and especially by rapid growth in the Hispanic population and the Hispanic population share. The phenomenon is by no means singular to San Diego County. A similar trend is evident in much of California. In particular, the share of Hispanics as a percent of the total population has been rising rapidly in much of Southern California. In some nearby counties, for instance Los Angeles County, the share of Hispanics exceeds the share in San Diego.

---

[8] *Source:* The California Department of Housing and Community Development, *California's Deepening Housing Crisis*. http://www.hcd.ca.gov/hpd/hc021506.pdf.

[9] *Source:* The Office of Federal Housing Enterprise Oversight. http://www.ofheo.gov/media/pdf/4q05hpi.pdf

[10] *Source:* The California Department of Housing and Community Development, *California's Deepening Housing Crisis*. http://www.hcd.ca.gov/hpd/hc021506.pdf.

San Diego experienced a strong upturn in population growth in the late 1990s, driven by a combination of international immigration, net domestic migration, and natural increase. The demographic make-up of San Diego County, and of Southern California generally—because of this location's proximity to Mexico along with its status as a trans-Pacific entry point—is undergoing pronounced diversification. San Diego has also emerged as one of California's most economically dynamic urban centers, further spurring population growth. San Diego County's ethnic diversity correlates with a birth rate that exceeds the state average and an age cohort distribution that is correspondingly weighted toward higher representation of younger people.

Births The counties in Southern California (Imperial, Orange, Los Angeles, Riverside, San Bernardino, and San Diego) are likely to record birth rates higher than the state average into the future, correlated with their largely Hispanic ethnic make-up. Likewise, population growth in San Diego County will be boosted by a comparatively greater number of natural births, primarily associated with an increased number of ethnically diverse women in the county.

Deaths The life expectancy rates used in the San Diego County forecast reflect the county's gender, age, race, and Hispanic origin components. Life expectancies are increasing for all groups. The projected absolute increase in the number of deaths recorded yearly reflects a much higher percentage of elderly as a share of the total population in upcoming years, as well as a continuous increase in the overall population base. Despite an anticipated gradual decline in fertility rates, the positive differential on total annual births minus total annual deaths rises significantly for San Diego County throughout the long-term forecast.

Migration International migration is at present the largest driver of population growth in San Diego County. A trough in domestic migration was reached in 1993, when 34,000 persons on net moved away from the county. Negative domestic migration continued through 1996, but the turnaround to positive domestic migration in the late 1990's was emphatic, and continued through the early years of this decade.

Annual international immigration to San Diego ranged between 14,000 and 19,000 during the 1990s. That experience has been repeated this decade, with over 90,000 arrivals through June 2005. Global Insight forecasts this number declining to approximately 13,000 annually during the 2010-2020 decade. A subsequent increase in international immigration is projected; a peak of just over 18,000 per year will be reached in the early 2030s and the annual influx will then ease slightly through 2040.

Domestic migration, both within California and between California and other states, is a volatile demographic component because it substantially depends on relative differences in economic conditions across the state and nation. In many cases, such differences arise from discontinuous developments or exogenous factors that cannot be predicted from a standard trend analysis. Domestic in-migration began to wane at the start of this decade. Then, with home prices escalating and affordability declining, net domestic migration turned sharply negative in 2003. However, the magnitude of the net outflow is uncertain. The California Department of Finance estimates the net outflow of residents at 7,200 in 2004, and 12,400 in 2005. The Bureau of the Census meanwhile estimates the net out-migration from San Diego had been 97,500 this decade, with an outflow of 43,100 in 2005. The two sources also result in different estimates of the county's current share of state population. The Bureau of the Census estimates result in a 2005 share of 8.12%, while the Department of Finance estimates result in a share for San Diego of 8.26%.

These preliminary estimates will be revised in 2007 as further data becomes available from the IRS based on tax returns filed in 2006. For this reason, and given the wide disparity in the migration component, this report assumes, for the purpose of generating a forecast, that in 2005 the actual domestic migration is an average of the two sources, or 28,000. There is no reason a priori to give greater credence to either estimate. This assumption affects this forecast in two ways - first in setting the starting, 2005, point in applying the results of the economic and demographic change models, and second, in the behavior over time of the domestic out-migration. The economic model predicts a decline in the net outflow, the magnitude of which we attribute to the extremely high housing prices in the county. The normalization of the migration behavior, to its long run equilibrium, spans a longer time period (into the next decade) if it

starts from a level as high as the Census 2005 estimate indicates. As a consequence, San Diego's 2010 population would be lower than that of this forecast.

The local real estate market clearly peaked in 2005. We anticipate that home price appreciation will be muted going forward for a considerable period of time. Net migration outflows will gradually moderate to an annual rate of less than 10,000, but they will remain negative for the forecast period. Another major consideration over the longer term is that constraints will begin to appear in San Diego County's supply of available developable land, which for now is quite abundant. By the outer forecast years, persons seeking to avoid congestion, or "trading up" to more spacious housing, will tend, with increasing frequency, to move away from San Diego County to less intensively built-up areas. Similar constraints on nonresidential development will raise costs and reduce enterprises' options for physical expansion. The pace of economic activity in San Diego County can therefore be expected to moderate, which will also tend to dampen in-migration and in some cases induce out-migration.

Global Insight projects San Diego County's population to rise by 54% during the next 40 years, from an estimated 2,813,833 in 2000 to 4,340,977 in 2040. Factors supporting this robust growth include geographic location, ethnic diversity, and cost of living considerations. Climate, scenery, and cultural amenities assure that San Diego will continue to enjoy an outstandingly high rating for quality of life. It is likely to demonstrate enduring and conceivably increasing ability to draw high-income residents and high-end development.

San Diego County is wedged between Mexico to the south and highly urbanized Orange County to the north, with the Pacific Ocean to the west. It is thus a natural destination for Mexican, other Latin American, and Asian immigrants. Foreign immigration has served as an important driver of both population and economic growth in San Diego and throughout Southern California. In the Los Angeles region in the late 1990s, immigrants gravitated in massive numbers to low-level service industry jobs, positions that would have been difficult to fill otherwise and that were essential in fueling the area's extraordinary boom. Within San Diego County, tourism is a large and increasingly important sector, and a ready supply of immigrant labor helps to maintain staff levels and to moderate wage costs in this industry. Immigrant workers have also played a vital role in the county's surging construction activity. While San Diego County will continue to be a gateway for international immigration, the number of those arriving from foreign countries who settle permanently in the county is likely to ease somewhat in the near future. On one hand, the recent pace of expansion is not sustainable through the long term, and job opportunities for lower-skilled services workers and laborers will probably soon become less plentiful. On the other, increases in the local cost of living driven by San Diego's recent boom will encourage many, both immigrant and US-born, to locate in less expensive places.

Into the medium term, San Diego's population growth will be supported by relatively extensive developable land. The city of San Diego is by far the county's largest municipality, at about 1.25 million people. Other jurisdictions include Carlsbad, Chula Vista, Coronado, Del Mar, Encinitas, Escondido, La Mesa, Oceanside, Poway, San Marcos, Santee, and Vista. Besides San Diego, only three municipalities in the county currently exceed 100,000 in population: Chula Vista, Oceanside, and Escondido. Some appreciation of San Diego's capacity to support substantial population increases can be derived from the observation that neighboring Orange County, with less than one-fifth of San Diego County's land area, has seven cities of more than 100,000 people.

The forecast share of the California population in San Diego County in 2040 is 8.42%, a modest increase over the 8.31% share San Diego County had in 2000. In terms of absolute population numbers, San Diego County will gain about 1.5 million additional residents over the course of the forecast period.

Chapter 6
Alternative Forecasts

Comparison with DRI•WEFA 2001 Forecast

In 2001, Global Insight (then DRI•WEFA) presented a similar study "A Forecast of Population (1999-2040) for Counties in California including San Diego County". In that report we projected that the San Diego share of California population would increase to 8.37% in 2010 to 8.59% in 2020, 8.92% in 2030, and to 9.28% in 2040. The current forecast is for somewhat lower shares for San Diego County. The County's share will decline to 7.97% in 2010, and then rise to 8.42% in 2040.

Estimates by the Bureau of the Census released on March 16, 2006 indicate that San Diego population in 2005 was 2,933,462, 3.1% lower than that projected in our 2001 forecast. In that earlier forecast we had anticipated that net domestic migration would turn negative by 2015. However, data this decade indicate that net outflows began in 2003. As a result, we have lowered our migration estimates in this report. For the state the estimated 2005 population was also somewhat lower than anticipated in 2001, for the similar reason that net outflows to other states accelerated in 2004 and 2005. For this reason we have also made a small downward adjustment in the state population forecast. The Census Bureau estimate of the San Diego share of state population in 2005 is 8.12%. This estimate is somewhat lower than DRI•WEFA's 2001 forecast of 8.33%.

California Department of Finance

The California Department of Finance ("DOF") has also projected California county population over a 40-year period. The DOF forecasted that by 2040, total California population would be 51,538,596, just 0.2% lower than our 2040 projection of 51,549,610 presented in this document. Our projected state population shares at the county level exceed those of the DOF generally in Southern California. These differences are balanced by somewhat lower projected shares in Northern California and the Central Valley.

For San Diego County, DOF projects a population of 4,289,739 in 2040, 1.2% lower than the corresponding projection of 4,340,977 of this report. As a result DOF's projected share of the 2040 California population in San Diego County is, at 8.32%, 0.1 percentage point lower than Global Insight's projected share of 8.42%. Table 5 below compares the county projections from Global Insight that form the basis of this report with the projections by California Department of Finance, through the year 2040.

Table 5
Comparison of Population Projections

	Global Insight		CA DOF	
YEAR	San Diego Co. Pop.	Share of State	San Diego Co. Pop.	Share of State
2010	3,071,382	7.97%	3,258,951	8.30%
2020	3,469,819	8.09%	3,633,572	8.29%
2030	3,883,651	8.23%	4,005,624	8.33%
2040	4,340,977	8.42%	4,289,739	8.32%

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX C

MASTER SETTLEMENT AGREEMENT

(THIS PAGE INTENTIONALLY LEFT BLANK)

MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

TABLE OF CONTENTS

Page

MASTER SETTLEMENT AGREEMENT

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or, solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection

IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States.

(g) "Allocated Payment" means a particular Settling State's Allocable Share of the sum of all of the payments to be made by the Original Participating Manufacturers in the year in question pursuant to subsections IX(c)(1) and IX(c)(2), as such payments have been adjusted, reduced and allocated pursuant to clause "First" through the first sentence of clause "Fifth" of subsection IX(j), but before application of the other offsets and adjustments described in clauses "Sixth" through "Thirteenth" of subsection IX(j).

(h) "Bankruptcy" means, with respect to any entity, the commencement of a case or other proceeding (whether voluntary or involuntary) seeking any of (1) liquidation, reorganization, rehabilitation, receivership, conservatorship, or other relief with respect to such entity or its debts under any bankruptcy, insolvency or similar law now or hereafter in effect; (2) the appointment of a trustee, receiver, liquidator, custodian or similar official of such entity or any substantial part of its business or property; (3) the consent of such entity to any of the relief described in (1) above or to the appointment of any official described in (2) above in any such case or other proceeding involuntarily commenced against such entity; or (4) the entry of an order for relief as to such entity under the federal bankruptcy laws as now or hereafter in effect. Provided, however, that an involuntary case or proceeding otherwise within the foregoing definition shall not be a "Bankruptcy" if it is or was dismissed within 60 days of its commencement.

(i) "Brand Name" means a brand name (alone or in conjunction with any other word), trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any domestic brand of Tobacco Products. Provided, however, that the term "Brand Name" shall not include the corporate name of any Tobacco Product Manufacturer that does not after the MSA Execution Date sell a brand of Tobacco Products in the States that includes such corporate name.

(j) "Brand Name Sponsorship" means an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way. Sponsorship of a single national or multi-state series or tour (for example, NASCAR (including any number of NASCAR races)), or of one or more events within a single national or multi-state series or tour, or of an entrant, participant, or team taking part in events sanctioned by a single approving organization (e.g., NASCAR or CART), constitutes one Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in an event that is part of a series or tour that is sponsored by such Participating Manufacturer or that is part of a series or tour in which any one or more events are sponsored by such Participating Manufacturer does not constitute a separate Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in any event (or series of events) not sponsored by such Participating Manufacturer constitutes a Brand Name Sponsorship. The term "Brand Name Sponsorship" shall not include an event in an Adult-Only Facility.

(k) "Business Day" means a day which is not a Saturday or Sunday or legal holiday on which banks are authorized or required to close in New York, New York.

(l) "Cartoon" means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:

(1) the use of comically exaggerated features;

(2) the attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or

(3) the attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

The term "Cartoon" includes "Joe Camel," but does not include any drawing or other depiction that on July 1, 1998, was in use in any State in any Participating Manufacturer's corporate logo or in any Participating Manufacturer's Tobacco Product packaging.

(m) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "Cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). Except as provided in subsections II(z) and II(mm), 0.0325 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(n) "Claims" means any and all manner of civil (i.e., non-criminal) claims, demands, actions, suits, causes of action, damages (whenever incurred), liabilities of any nature including civil penalties and punitive damages, as well as costs, expenses and attorneys' fees (except as to the Original Participating Manufacturers' obligations under section XVII), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable, or statutory.

(o) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

(q) "Escrow" has the meaning given in the Escrow Agreement.

(r) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(s) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(t) "Federal Tobacco Legislation Offset" means the offset described in section X.

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing

outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

(2) is the first purchaser anywhere for resale in the States of Cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the States; or

(3) becomes a successor of an entity described in subsection (1) or (2) above.

The term "Tobacco Product Manufacturer" shall not include an Affiliate of a Tobacco Product Manufacturer unless such Affiliate itself falls within any of subsections (1) - (3) above.

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location. Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no

event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa) "Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

III. PERMANENT RELIEF

(a) Prohibition on Youth Targeting. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) Ban on Use of Cartoons. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) Limitation of Tobacco Brand Name Sponsorships.

(1) Prohibited Sponsorships. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) Limited Sponsorships.

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) Related Sponsorship Restrictions. With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

(D) nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name

Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) Corporate Name Sponsorships. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) Naming Rights Prohibition. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) Prohibition on Sponsoring Teams and Leagues. No Participating Manufacturer may enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) Elimination of Outdoor Advertising and Transit Advertisements. Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) Removal. Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) Prohibition on New Outdoor Advertising and Transit Advertisements. No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) Alternative Advertising. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) Ban on Agreements Inhibiting Anti-Tobacco Advertising. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) Designation of Contact Person. Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) Adult-Only Facilities. To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) Prohibition on Payments Related to Tobacco Products and Media. No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) Ban on Tobacco Brand Name Merchandise. Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or

terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) Ban on Youth Access to Free Samples. After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase. Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) Limitation on Third-Party Use of Brand Names. After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) Ban on Non-Tobacco Brand Names. No Participating Manufacturer may, pursuant to any agreement requiring the payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) Minimum Pack Size of Twenty Cigarettes. No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) Corporate Culture Commitments Related to Youth Access and Consumption. Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;

designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and

encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) Limitations on Lobbying. Following State-Specific Finality in a Settling State:

(1) No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

(2) Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

(A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);

(B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

(3) No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) Restriction on Advocacy Concerning Settlement Proceeds. After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in

accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc. ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

(p) Regulation and Oversight of New Tobacco-Related Trade Associations.

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) Prohibition on Agreements to Suppress Research. No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) Prohibition on Material Misrepresentations. No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

IV. PUBLIC ACCESS TO DOCUMENTS

(a) After the MSA Execution Date, the Original Participating Manufacturers and the Tobacco-Related Organizations will support an application for the dissolution of any protective orders entered in each Settling State's lawsuit identified in Exhibit D with respect only to those documents, indices and privilege logs that have been produced as of the MSA Execution Date to such Settling State and (1) as to which defendants have made no claim, or have withdrawn any claim, of attorney-client privilege, attorney work-product protection, common interest/joint defense privilege (collectively, "privilege"), trade-secret protection, or confidential or proprietary business information; and (2) that are not inappropriate for public disclosure because of personal privacy interests or contractual rights of third parties that may not be abrogated by the Original Participating Manufacturers or the Tobacco-Related Organizations.

(b) Notwithstanding State-Specific Finality, if any order, ruling or recommendation was issued prior to September 17, 1998 rejecting a claim of privilege or trade-secret protection with respect to any document or documents in a lawsuit identified in Exhibit D, the Settling State in which such order, ruling or recommendation was made may, no later than 45 days after the occurrence of State-Specific Finality in such Settling State, seek public disclosure of such document or documents by application to the court that issued such order, ruling or recommendation and the court shall retain jurisdiction for such purposes. The Original Participating Manufacturers and Tobacco-Related Organizations do not consent to, and may object to, appeal from or otherwise oppose any such application for disclosure. The Original Participating Manufacturers and Tobacco-Related Organizations will not assert that the settlement of such lawsuit has divested the court of jurisdiction or that such Settling State lacks standing to seek public disclosure on any applicable ground.

(c) The Original Participating Manufacturers will maintain at their expense their Internet document websites accessible through "TobaccoResolution.com" or a similar website until June 30, 2010. The Original Participating Manufacturers will maintain the documents that currently appear on their respective websites and will add additional documents to their websites as provided in this section IV.

(d) Within 180 days after the MSA Execution Date, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of the following documents, except as provided in subsections IV(e) and IV(f) below:

(1) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in any action identified in Exhibit D or any action identified in section 2 of Exhibit H that was filed by an Attorney General. Among these documents, each Original Participating Manufacturer and Tobacco-Related Organization will give the highest priority to (A) the documents that were listed by the State of Washington as trial exhibits in the State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King); and (B) the documents as to which such Original Participating Manufacturer or Tobacco-Related Organization withdrew any claim of privilege as a result of the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County);

(2) all documents that can be identified as having been produced by, and copies of transcripts of depositions given by, such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in the litigation matters specified in section 1 of Exhibit H; and

(3) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date and listed by the plaintiffs as trial exhibits in the litigation matters specified in section 2 of Exhibit H.

(e) Unless copies of such documents are already on its website, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of documents produced in any production of documents that takes place on or after the date 30 days before the MSA Execution Date in any federal or state court civil action concerning smoking and health. Copies of any documents required to be placed on a website pursuant to this subsection will be placed on such website within the later of 45 days after the MSA Execution Date or within 45 days after the production of such documents in any federal or state court action concerning smoking and health. This obligation will continue until June 30, 2010. In placing such newly produced documents on its website, each Original Participating Manufacturer or Tobacco-Related Organization will identify, as part of its index to be created pursuant to subsection IV(h), the action in which it produced such documents and the date on which such documents were added to its website.

(f) Nothing in this section IV shall require any Original Participating Manufacturer or Tobacco-Related Organization to place on its website or otherwise disclose documents that: (1) it continues to claim to be privileged, a trade secret, confidential or proprietary business information, or that contain other information not appropriate for public disclosure because of personal privacy interests or contractual rights of third parties; or (2) continue to be subject to any protective order, sealing order or other order or ruling that prevents or limits a litigant from disclosing such documents.

(g) Oversized or multimedia records will not be required to be placed on the Website, but each Original Participating Manufacturers and Tobacco-Related Organizations will make any such records available to the public by placing copies of them in the document depository established in The State of Minnesota, et al. v. Philip Morris Incorporated, et al., C1-94-8565 (County of Ramsey, District Court, 2d Judicial Cir.).

(h) Each Original Participating Manufacturer will establish an index and other features to improve searchable access to the document images on its website, as set forth in Exhibit I.

(i) Within 90 days after the MSA Execution Date, the Original Participating Manufacturers will furnish NAAG with a project plan for completing the Original Participating Manufacturers' obligations under subsection IV(h) with respect to documents currently on their websites and documents being placed on their websites pursuant to subsection IV(d). NAAG may engage a computer consultant at the Original Participating Manufacturers' expense for a period not to exceed two years and at a cost not to exceed $100,000. NAAG's computer consultant may review such plan and make recommendations consistent with this Agreement. In addition, within 120 days after the completion of the Original Participating Manufacturers' obligations under subsection IV(d), NAAG's computer consultant may make final recommendations with respect to the websites consistent with this Agreement. In preparing these recommendations, NAAG's computer consultant may seek input from Settling State officials, public health organizations and other users of the websites.

(j) The expenses incurred pursuant to subsection IV(i), and the expenses related to documents of the Tobacco-Related Organizations, will be severally shared among the Original Participating Manufacturers (allocated among them according to their Relative Market Shares). All other expenses incurred under this section will be borne by the Original Participating Manufacturer that incurs such expense.

V. TOBACCO CONTROL AND UNDERAGE USE LAWS

Each Participating Manufacturer agrees that following State-Specific Finality in a Settling State it will not initiate, or cause to be initiated, a facial challenge against the enforceability or constitutionality of such Settling State's (or such Settling State's political subdivisions') statutes, ordinances and administrative rules relating to tobacco control enacted prior to June 1, 1998 (other than a statute, ordinance or rule challenged in any lawsuit listed in Exhibit M).

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION

(a) Foundation Purposes. The Settling States believe that a comprehensive, coordinated program of public education and study is important to further the remedial goals of this Agreement. Accordingly, as part of the settlement of claims described herein, the payments specified in subsections VI(b), VI(c), and IX(e) shall be made to a charitable foundation, trust or similar organization (the "Foundation") and/or to a program to be operated within the Foundation (the "National Public Education Fund"). The purposes of the Foundation will be to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the use of Tobacco Products in the States.

(b) Base Foundation Payments. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each Original Participating Manufacturer shall severally pay its Relative Market Share of $25,000,000 to fund the Foundation. The payments to be made by each of the Original Participating Manufacturers pursuant to this subsection (b) shall be subject to no adjustments, reductions, or offsets, and shall be paid to the Escrow Agent (to be credited to the Subsection VI(b) Account), who shall disburse such payments to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State.

(c) National Public Education Fund Payments.

(1) Each Original Participating Manufacturer shall severally pay its Relative Market Share of the following base amounts on the following dates to the Escrow Agent for the benefit of the Foundation's National Public Education Fund to be used for the purposes and as described in subsections VI(f)(1), VI(g) and VI(h) below: $250,000,000 on March 31, 1999; $300,000,000 on March 31, 2000; $300,000,000 on March 31, 2001; $300,000,000 on March 31, 2002; and $300,000,000 on March 31, 2003, as such amounts are modified in accordance with this subsection (c). The payment due on March 31, 1999 pursuant to this subsection (c)(1) is to be credited to the Subsection VI(c) Account (First). The payments due on or after March 31, 2000 pursuant to this subsection VI(c)(1) are to be credited to the Subsection VI(c) Account (Subsequent).

(2) The payments to be made by the Original Participating Manufacturers pursuant to this subsection (c), other than the payment due on March 31, 1999, shall be subject to the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments described in subsection XI(i).

(3) The payment made pursuant to this subsection (c) on March 31, 1999 shall be disbursed by the Escrow Agent to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State. Each remaining payment pursuant to this subsection (c) shall be disbursed by the Escrow Agent to the Foundation only when State-Specific Finality has occurred in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date.

(4) In addition to the payments made pursuant to this subsection (c), the National Public Education Fund will be funded (A) in accordance with subsection IX(e), and (B) through monies contributed by other entities directly to the Foundation and designated for the National Public Education Fund ("National Public Education Fund Contributions").

(5) The payments made by the Original Participating Manufacturers pursuant to this subsection (c) and/or subsection IX(e) and monies received from all National Public Education Fund Contributions will be deposited and invested in accordance with the laws of the state of incorporation of the Foundation.

(d) Creation and Organization of the Foundation. NAAG, through its executive committee, will provide for the creation of the Foundation. The Foundation shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Internal Revenue Code section 501(c)(3). The organizational documents of the Foundation shall specifically incorporate the provisions of this Agreement relating to the Foundation, and will provide for payment of the Foundation's administrative expenses from the funds paid pursuant to subsection VI(b) or VI(c). The Foundation shall be governed by a board of directors. The board of directors shall be comprised of eleven directors. NAAG, the National Governors' Association ("NGA"), and the National Conference of State Legislatures ("NCSL") shall each select from its membership two directors. These six directors shall select the five additional directors. One of these five additional directors shall have expertise in public health issues. Four of these five additional directors shall have expertise in medical, child psychology, or public health disciplines. The board of directors shall be nationally geographically diverse.

(e) Foundation Affiliation. The Foundation shall be formally affiliated with an educational or medical institution selected by the board of directors.

(f) Foundation Functions. The functions of the Foundation shall be:

(1) carrying out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products;

(2) developing and disseminating model advertising and education programs to counter the use by Youth of substances that are unlawful for use or purchase by Youth, with an emphasis on reducing Youth smoking; monitoring and testing the effectiveness of such model programs; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;

(3) developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations; monitoring and testing the effectiveness of such model programs and ideas; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs or ideas, as appropriate;

(4) developing and disseminating criteria for effective cessation programs; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;

(5) commissioning studies, funding research, and publishing reports on factors that influence Youth smoking and substance abuse and developing strategies to address the conclusions of such studies and research;

(6) developing other innovative Youth smoking and substance abuse prevention programs;

(7) providing targeted training and information for parents;

(8) maintaining a library open to the public of Foundation-funded studies, reports and other publications related to the cause and prevention of Youth smoking and substance abuse;

(9) tracking and monitoring Youth smoking and substance abuse, with a focus on the reasons for any increases or failures to decrease Youth smoking and substance abuse and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(j) below, or is a political subdivision in such a Settling State.

(h) Foundation Activities. The Foundation shall not engage in, nor shall any of the Foundation's money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or other similar activities. The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. The Foundation shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner. The Foundation's activities (including the National Public Education Fund) shall be carried out solely within the States. The payments described in subsections VI(b) and VI(c) above are made at the direction and on behalf of Settling States. By making such payments in such manner, the Participating Manufacturers do not undertake and expressly disclaim any responsibility with respect to the creation, operation, liabilities, or tax status of the Foundation or the National Public Education Fund.

(i) Severance of this Section. If the Attorney General of a Settling State determines that such Settling State may not lawfully enter into this section VI as a matter of applicable state law, such Attorney General may sever this section VI from its settlement with the Participating Manufacturers by giving written notice of such severance to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k) hereof. If any Settling State exercises its right to sever this section VI, this section VI shall not be considered a part of the specific settlement between such Settling State and the Participating Manufacturers, and this section VI shall not be enforceable by or in such Settling State. The payment obligation of subsections VI(b) and VI(c) hereof shall apply regardless of a determination by one or more Settling States to sever section VI hereof; provided, however, that if all Settling States sever section VI hereof, the payment obligations of subsections (b) and (c) hereof shall be null and void. If the Attorney General of a Settling State that severed this section VI subsequently determines that such Settling State may lawfully enter into this section VI as a matter of applicable state law, such Attorney General may rescind such Settling State's previous severance of this section VI by giving written notice of such rescission to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k). If any Settling State rescinds such severance, this section VI shall be considered a part of the specific settlement between such Settling State and the Participating Manufacturers (including for purposes of subsection (g)(4)), and this section VI shall be enforceable by and in such Settling State.

VII. ENFORCEMENT

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XI(c) and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

(b) Enforcement of Consent Decree. Except as expressly provided in the Consent Decree, any Settling State or Released Party may apply to the Court to enforce the terms of the Consent Decree (or for a declaration construing any such term) with respect to alleged violations within such Settling State. A Settling State may not seek to enforce the Consent Decree of another Settling State; provided, however, that nothing contained herein shall affect the ability of any Settling State to (1) coordinate state enforcement actions or proceedings, or (2) file or join any amicus brief. In the event that the Court determines that any Participating Manufacturer or Settling State has violated the Consent Decree within such Settling State, the party that initiated the proceedings may request any and all relief available within such Settling State pursuant to the Consent Decree.

(c) Enforcement of this Agreement.

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) Right of Review. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

(e) Applicability. This Agreement and the Consent Decree apply only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a breach or violation of this Agreement or the Consent Decree (or any Declaratory Order or Enforcement Order issued in connection with this Agreement or the Consent Decree) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach or violation, and the Court shall have no jurisdiction to do so.

(f) Coordination of Enforcement. The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling States shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

(g) Inspection and Discovery Rights. Without limitation on whatever other rights to access they may be permitted by law, following State-Specific Finality in a Settling State and for seven years thereafter, representatives of the Attorney General of such Settling State may, for the purpose of enforcing this Agreement and the Consent Decree, upon reasonable cause to believe that a violation of this Agreement or the Consent Decree has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days): (1) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of each Participating Manufacturer insofar as they pertain to such believed violation; and (2) interview each Participating Manufacturer's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation. Documents and information provided to representatives of the Attorney General of such Settling State pursuant to this section VII shall be kept confidential by the Settling States, and shall be utilized only by the Settling States and only for purposes of enforcing this Agreement, the Consent Decree and the criminal law. The inspection and discovery rights provided to such Settling State pursuant to this subsection shall be coordinated through NAAG so as to avoid repetitive and excessive inspection and discovery.

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES

(a) Upon approval of the NAAG executive committee, NAAG will provide coordination and facilitation for the implementation and enforcement of this Agreement on behalf of the Attorneys General of the Settling States, including the following:

(1) NAAG will assist in coordinating the inspection and discovery activities referred to in subsections III(p)(3) and VII(g) regarding compliance with this Agreement by the Participating Manufacturers and any new tobacco-related trade associations.

(2) NAAG will convene at least two meetings per year and one major national conference every three years for the Attorneys General of the Settling States, the directors of the Foundation and three persons designated by each Participating Manufacturer. The purpose of the meetings and conference is to evaluate the success of this Agreement and coordinate efforts by the Attorneys General and the Participating Manufacturers to continue to reduce Youth smoking.

(3) NAAG will periodically inform NGA, NCSL, the National Association of Counties and the National League of Cities of the results of the meetings and conferences referred to in subsection (a)(2) above.

(4) NAAG will support and coordinate the efforts of the Attorneys General of the Settling States in carrying out their responsibilities under this Agreement.

(5) NAAG will perform the other functions specified for it in this Agreement, including the functions specified in section IV.

(b) Upon approval by the NAAG executive committee to assume the responsibilities outlined in subsection VIII(a) hereof, each Original Participating Manufacturer shall cause to be paid, beginning on December 31, 1998, and on December 31 of each year thereafter through and including December 31, 2007, its Relative Market Share of $150,000 per year to the Escrow Agent (to be credited to the Subsection VIII(b) Account), who shall disburse such monies to NAAG within 10 Business Days, to fund the activities described in subsection VIII(a).

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") in the form attached as Exhibit J, which will be maintained by

such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products, as set forth in Exhibit J. Each Original Participating Manufacturer shall on March 31, 1999, severally pay its Relative Market Share of $50,000,000 to the Escrow Agent (to be credited to the Subsection VIII(c) Account), who shall disburse such monies to NAAG upon the occurrence of State-Specific Finality in at least one Settling State. Such funds will be used in accordance with the provisions of Exhibit J.

IX. PAYMENTS

(a) All Payments Into Escrow. All payments made pursuant to this Agreement (except those payments made pursuant to section XVII) shall be made into escrow pursuant to the Escrow Agreement, and shall be credited to the appropriate Account established pursuant to the Escrow Agreement. Such payments shall be disbursed to the beneficiaries or returned to the Participating Manufacturers only as provided in section XI and the Escrow Agreement. No payment obligation under this Agreement shall arise (1) unless and until the Escrow Court has approved and retained jurisdiction over the Escrow Agreement or (2) if such approval is reversed (unless and until such reversal is itself reversed). The parties agree to proceed as expeditiously as possible to resolve any issues that prevent approval of the Escrow Agreement. If any payment (other than the first initial payment under subsection IX(b)) is delayed because the Escrow Agreement has not been approved, such payment shall be due and payable (together with interest at the Prime Rate) within 10 Business Days after approval of the Escrow Agreement by the Escrow Court.

(b) Initial Payments. On the second Business Day after the Escrow Court approves and retains jurisdiction over the Escrow Agreement, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(b) Account (First)) its Market Capitalization Percentage (as set forth in Exhibit K) of the base amount of $2,400,000,000. On January 10, 2000, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,472,000,000. On January 10, 2001, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,546,160,000. On January 10, 2002, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,622,544,800. On January 10, 2003, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,701,221,144. The payments pursuant to this subsection (b) due on or after January 10, 2000 shall be credited to the Subsection IX(b) Account (Subsequent). The foregoing payments shall be modified in accordance with this subsection (b). The payments made by the Original Participating Manufacturers pursuant to this subsection (b) (other than the first such payment) shall be subject to the Volume Adjustment, the Non-Settling States Reduction and the offset for miscalculated or disputed payments described in subsection XI(i). The first payment due under this subsection (b) shall be subject to the Non-Settling States Reduction, but such reduction shall be determined as of the date one day before such payment is due (rather than the date 15 days before).

(c) Annual Payments and Strategic Contribution Payments.

(1) On April 15, 2000 and on April 15 of each year thereafter in perpetuity, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(1) Account) its Relative Market Share of the base amounts specified below, as such payments are modified in accordance with this subsection (c)(1):

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

The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(1) shall be subject to the Inflation Adjustment, the Volume Adjustment, the Previously Settled States Reduction, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal

Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8).

(2) On April 15, 2008 and on April 15 of each year thereafter through 2017, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(2) Account) its Relative Market Share of the base amount of $861,000,000, as such payments are modified in accordance with this subsection (c)(2). The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2) (and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) Non-Participating Manufacturer Adjustment.

(1) Calculation of NPM Adjustment for Original Participating Manufacturers. To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (1) the Variable Multiplier and (2) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the

Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting through a principal or principals acceptable to such parties, if such a person can be identified and, if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

(2) Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their respective Allocable Shares, and such other Settling States' Allocated Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model

Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating

Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of *(1)* 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or *(2)* 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) Supplemental Payments. Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) Payment Responsibility. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) Corporate Structures. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) Accrual of Interest. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) Payments by Subsequent Participating Manufacturers.

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufacturer shall make payments corresponding to those due in that same following year from the Original Participating Manufacturers pursuant to subsections VI(c) (except for the payment due on March 31, 1999), IX(c)(1), IX(c)(2) and IX(e). The amounts of such corresponding payments by a Subsequent Participating Manufacturer are in addition to the corresponding payments that are due from the Original Participating Manufacturers and shall be determined as described in subsections (2) and (3) below. Such payments by a Subsequent Participating Manufacturer shall (A) be due on the same dates as the corresponding payments are due from Original Participating Manufacturers; (B) be for the same

purpose as such corresponding payments; and (C) be paid, allocated and distributed in the same manner as such corresponding payments.

(2) The base amount due from a Subsequent Participating Manufacturer on any given date shall be determined by multiplying (A) the corresponding base amount due on the same date from all of the Original Participating Manufacturers (as such base amount is specified in the corresponding subsection of this Agreement and is adjusted by the Volume Adjustment (except for the provisions of subsection (B)(ii) of Exhibit E), but before such base amount is modified by any other adjustments, reductions or offsets) by (B) the quotient produced by dividing (i) the result of (x) such Subsequent Participating Manufacturer's applicable Market Share (the applicable Market Share being that for the calendar year immediately preceding the year in which the payment in question is due) minus (y) the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share, by (ii) the aggregate Market Shares of the Original Participating Manufacturers (the applicable Market Shares being those for the calendar year immediately preceding the year in which the payment in question is due).

(3) Any payment due from a Subsequent Participating Manufacturer under subsections (1) and (2) above shall be subject (up to the full amount of such payment) to the Inflation Adjustment, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8), to the extent that such adjustments, reductions or offsets would apply to the corresponding payment due from the Original Participating Manufacturers. Provided, however, that all adjustments and offsets to which a Subsequent Participating Manufacturer is entitled may only be applied against payments by such Subsequent Participating Manufacturer, if any, that are due within 12 months after the date on which the Subsequent Participating Manufacturer becomes entitled to such adjustment or makes the payment that entitles it to such offset, and shall not be carried forward beyond that time even if not fully used.

(4) For purposes of this subsection (i), the 1997 (or 1998, as applicable) Market Share (and 125 percent thereof) of those Subsequent Participating Manufacturers that either (A) became a signatory to this Agreement more than 60 days after the MSA Execution Date or (B) had no Market Share in 1997 (or 1998, as applicable), shall equal zero.

(j) Order of Application of Allocations, Offsets, Reductions and Adjustments. The payments due under this Agreement shall be calculated as set forth below. The "base amount" referred to in clause "First" below shall mean (1) in the case of payments due from Original Participating Manufacturers, the base amount referred to in the subsection establishing the payment obligation in question; and (2) in the case of payments due from a Subsequent Participating Manufacturer, the base amount referred to in subsection (i)(2) for such Subsequent Participating Manufacturer. In the event that a particular adjustment, reduction or offset referred to in a clause below does not apply to the payment being calculated, the result of the clause in question shall be deemed to be equal to the result of the immediately preceding clause. (If clause "First" is inapplicable, the result of clause "First" will be the base amount of the payment in question prior to any offsets, reductions or adjustments.)

First: the Inflation Adjustment shall be applied to the base amount of the payment being calculated;

Second: the Volume Adjustment (other than the provisions of subsection (B)(iii) of Exhibit E) shall be applied to the result of clause "First";

Third: the result of clause "Second" shall be reduced by the Previously Settled States Reduction;

Fourth: the result of clause "Third" shall be reduced by the Non-Settling States Reduction;

Fifth: in the case of payments due under subsections IX(c)(1) and IX(c)(2), the results of clause "Fourth" for each such payment due in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together to form such Settling State's Allocated Payment. In the case of payments due under subsection IX(i) that correspond to payments due under subsections IX(c)(1) or IX(c)(2), the results of clause "Fourth" for all such payments due from a particular Subsequent Participating Manufacturer in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together. (In the case of all other payments made pursuant to this Agreement, this clause "Fifth" is inapplicable.);

Sixth: the NPM Adjustment shall be applied to the results of clause "Fifth" pursuant to subsections IX(d)(1) and (d)(2) (or, in the case of payments due from the Subsequent Participating Manufacturers, pursuant to subsection IX(d)(4));

Seventh: in the case of payments due from the Original Participating Manufacturers to which clause "Fifth" (and therefore clause "Sixth") does not apply, the result of clause "Fourth" shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares. In the case of payments due from the Original Participating Manufacturers to which clause "Fifth" applies: (A) the Allocated Payments of all Settling States determined pursuant to clause "Fifth" (prior to reduction pursuant to clause "Sixth") shall be added together; (B) the resulting sum shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares and subsection (B)(iii) of Exhibit E hereto (if such subsection is applicable); (C) the Available NPM Adjustment (as determined pursuant to clause "Sixth") shall be allocated among the Original Participating Manufacturers pursuant to subsection IX(d)(3); (D) the respective result of step (C) above for each Original Participating Manufacturer shall be subtracted from the respective result of step (B) above

for such Original Participating Manufacturer; and (E) the resulting payment amount due from each Original Participating Manufacturer shall then be allocated among the Settling States in proportion to the respective results of clause "Sixth" for each Settling State. The offsets described in clauses "Eighth" through "Twelfth" shall then be applied separately against each Original Participating Manufacturer's resulting payment shares (on a Settling State by Settling State basis) according to each Original Participating Manufacturer's separate entitlement to such offsets, if any, in the calendar year in question. (In the case of payments due from Subsequent Participating Manufacturers, this clause "Seventh" is inapplicable.)

Eighth: the offset for miscalculated or disputed payments described in subsection XI(i) (and any carry-forwards arising from such offset) shall be applied to the results of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or to the results of clause "Sixth" (in the case of payments due from Subsequent Participating Manufacturers);

Ninth: the Federal Tobacco Legislation Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eighth";

Tenth: the Litigating Releasing Parties Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Ninth";

Eleventh: the offset for claims over pursuant to subsection XII(a)(4)(B) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Tenth";

Twelfth: the offset for claims over pursuant to subsection XII(a)(8) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eleventh"; and

Thirteenth: in the case of payments to which clause "Fifth" applies, the Settling States' allocated shares of the payments due from each Participating Manufacturer (as such shares have been determined in step (E) of clause "Seventh" in the case of payments from the Original Participating Manufacturers or in clause "Sixth" in the case of payments from the Subsequent Participating Manufacturers, and have been reduced by clauses "Eighth" through "Twelfth") shall be added together to state the aggregate payment obligation of each Participating Manufacturer with respect to the payments in question. (In the case of a payment to which clause "Fifth" does not apply, the aggregate payment obligation of each Participating Manufacturer with respect to the payment in question shall be stated by the results of clause "Eighth.")

X. EFFECT OF FEDERAL TOBACCO-RELATED LEGISLATION

(a) If federal tobacco-related legislation is enacted after the MSA Execution Date and on or before November 30, 2002, and if such legislation provides for payment(s) by any Original Participating Manufacturer (whether by settlement payment, tax or any other means), all or part of which are actually made available to a Settling State ("Federal Funds"), each Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any and all amounts that are paid by such Original Participating Manufacturer pursuant to such legislation and actually made available to such Settling State (except as described in subsections (b) and (c) below). Such offset shall be applied against the applicable Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of such Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment and has been reduced by offset, if any, pursuant to the offset for miscalculated or disputed payments). Such offset shall be made against such Original Participating Manufacturer's share of the first Allocated Payment due after such Federal Funds are first available for receipt by such Settling State. In the event that such offset would in any given year exceed such Original Participating Manufacturer's share of such Allocated Payment: (1) the offset to which such Original Participating Manufacturer is entitled under this section in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment, and (2) all amounts not offset by reason of subsection (1) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(b) The offset described in subsection (a) shall apply only to that portion of Federal Funds, if any, that are either unrestricted as to their use, or restricted to any form of health care or to any use related to tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) (other than that portion of Federal Funds, if any, that is specifically applicable to tobacco growers or communities dependent on the production of tobacco or Tobacco Products). Provided, however, that the offset described in subsection (a) shall not apply to that portion of Federal Funds, if any, whose receipt by such Settling State is conditioned upon or appropriately allocable to:

(1) the relinquishment of rights or benefits under this Agreement (including the Consent Decree); or

(2) actions or expenditures by such Settling State, unless:

(A) such Settling State chooses to undertake such action or expenditure;

(B) such actions or expenditures do not impose significant constraints on public policy choices; or

(C) such actions or expenditures are both: (i) related to health care or tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) and (ii) do not require such Settling State to expend state matching funds in an amount that is significant in relation to the amount of the Federal Funds made available to such Settling State.

(c) Subject to the provisions of subsection IX(i)(3), Subsequent Participating Manufacturers shall be entitled to the offset described in this section X to the extent that they are required to pay Federal Funds that would give rise to an offset under subsections (a) and (b) if paid by an Original Participating Manufacturer.

(d) Nothing in this section X shall (1) reduce the payments to be made to the Settling States under this Agreement other than those described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement; or (2) alter the Allocable Share used to determine each Settling State's share of the payments described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement. Nothing in this section X is intended to or shall reduce the total amounts payable by the Participating Manufacturers to the Settling States under this Agreement by an amount greater than the amount of Federal Funds that the Settling States could elect to receive.

XI. CALCULATION AND DISBURSEMENT OF PAYMENTS

(a) Independent Auditor to Make All Calculations.

(1) Beginning with payments due in the year 2000, an Independent Auditor shall calculate and determine the amount of all payments owed pursuant to this Agreement, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States, and shall perform all other calculations in connection with the foregoing (including, but not limited to, determining Market Share, Relative Market Share, Base Aggregate Participating Manufacturer Market Share and Actual Aggregate Participating Manufacturer Market Share). The Independent Auditor shall promptly collect all information necessary to make such calculations and determinations. Each Participating Manufacturer and each Settling State shall provide the Independent Auditor, as promptly as practicable, with information in its possession or readily available to it necessary for the Independent Auditor to perform such calculations. The Independent Auditor shall agree to maintain the confidentiality of all such information, except that the Independent Auditor may provide such information to Participating Manufacturers and the Settling States as set forth in this Agreement. The Participating Manufacturers and the Settling States agree to maintain the confidentiality of such information.

(2) Payments due from the Original Participating Manufacturers prior to January 1, 2000 (other than the first payment due pursuant to subsection IX(b)) shall be based on the 1998 Relative Market Shares of the Original Participating Manufacturers or, if the Original Participating Manufacturers are unable to agree on such Relative Market Shares, on their 1997 Relative Market Shares specified in Exhibit Q.

(b) Identity of Independent Auditor. The Independent Auditor shall be a major, nationally recognized, certified public accounting firm jointly selected by agreement of the Original Participating Manufacturers and those Attorneys General of the Settling States who are members of the NAAG executive committee, who shall jointly retain the power to replace the Independent Auditor and appoint its successor. Fifty percent of the costs and fees of the Independent Auditor (but in no event more than $300,000 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(h)). 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	0.6018680%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553534%
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	0.4498069%
Vermont	0.4111851%
Virginia	2.0447431%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

EXHIBIT B
FORM OF ESCROW AGREEMENT

This Escrow Agreement is entered into as of _____, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and _____ as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the Settling States and the Participating Manufacturers have entered into a settlement agreement entitled the "Master Settlement Agreement" (the "Agreement"); and

WHEREAS, the Agreement requires the Settling States and the Participating Manufacturers to enter into this Escrow Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

The Settling States and the Participating Manufacturers hereby appoint _____ to serve as Escrow Agent under this Agreement on the terms and conditions set forth herein, and the Escrow Agent, by its execution hereof, hereby accepts such appointment and agrees to perform the duties and obligations of the Escrow Agent set forth herein. The Settling States and the Participating Manufacturers agree that the Escrow Agent appointed under the terms of this Escrow Agreement shall be the Escrow Agent as defined in, and for all purposes of, the Agreement.

SECTION 2. *Definitions.*

(a) Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the Agreement.

(b) "Escrow Court" means the court of the State of New York to which the Agreement is presented for approval, or such other court as agreed to by the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question.

SECTION 3. *Escrow and Accounts.*

(a) All funds received by the Escrow Agent pursuant to the terms of the Agreement shall be held and disbursed in accordance with the terms of this Escrow Agreement. Such funds and any earnings thereon shall constitute the "Escrow" and shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the Settling States and the Participating Manufacturers.

(b) The Escrow Agent shall allocate the Escrow among the following separate accounts (each an "Account" and collectively the "Accounts"):

SUBSECTION VI(B) ACCOUNT
SUBSECTION VI(C) ACCOUNT (FIRST)
SUBSECTION VI(C) ACCOUNT (SUBSEQUENT)
SUBSECTION VIII(B) ACCOUNT
SUBSECTION VIII(C) ACCOUNT
SUBSECTION IX(B) ACCOUNT (FIRST)
SUBSECTION IX(B) ACCOUNT (SUBSEQUENT)
SUBSECTION IX(C)(1) ACCOUNT
SUBSECTION IX(C)(2) ACCOUNT
SUBSECTION IX(E) ACCOUNT
DISPUTED PAYMENTS ACCOUNT
STATE-SPECIFIC ACCOUNTS WITH RESPECT TO EACH SETTLING STATE IN WHICH STATE-SPECIFIC FINALITY OCCURS.

(c) All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement pursuant to (i) written instructions from the Independent Auditor; or (ii) written instructions from all of the following: all of the Original Participating Manufacturers; all of the Subsequent Participating Manufacturers that contributed to such amounts in such Account; and all of the Settling States (collectively, the "Escrow Parties"). In the event of a conflict, instructions pursuant to clause (ii) shall govern over instructions pursuant to clause (i).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been

credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

The Escrow Agent shall invest and reinvest all amounts from time to time credited to the Accounts in either (i) direct obligations of, or obligations the principal and interest on which are unconditionally guaranteed by, the United States of America; (ii) repurchase agreements fully collateralized by securities described in clause (i) above; (iii) money market accounts maturing within 30 days of the acquisition thereof and issued by a bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof (a "United States Bank") and having combined capital, surplus and undistributed profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undistributed profits in excess of $500,000,000. To the extent practicable, monies credited to any Account shall be invested in such a manner so as to be available for use at the times when monies are expected to be disbursed by the Escrow Agent and charged to such Account. Obligations purchased as an investment of monies credited to any Account shall be deemed at all times to be a part of such Account and the income or interest earned, profits realized or losses suffered with respect to such investments (including, without limitation, any penalty for any liquidation of an investment required to fund a disbursement to be charged to such Account), shall be credited or charged, as the case may be, to, such Account and shall be for the benefit of, or be borne by, the person or entity entitled to payment from such Account. In choosing among the investment options described in clauses (i) through (iv) above, the Escrow Agent shall comply with any instructions received from time to time from all of the Escrow Parties. In the absence of such instructions, the Escrow Agent shall invest such sums in accordance with clause (i) above. With respect to any amounts credited to a State-Specific Account, the Escrow Agent shall invest and reinvest all amounts credited to such Account in accordance with the law of the applicable Settling State to the extent such law is inconsistent with this Section 5.

SECTION 6. *Substitute Form W-9; Qualified Settlement Fund.*

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-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. IJU-97915 CI (Alaska)
3. Arizona
   State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)
4. Arkansas
   State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)
5. California
   People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301
6. Colorado
   State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV1432 (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. 97CVH05114 (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. 96-2-15056085EA (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(b) 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-cv-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, IL, 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.

---

[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 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]

---

[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.]

[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 D

MOU, ARIMOU, CONSENT DECREE AND CALIFORNIA ESCROW AGREEMENT

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUPERIOR COURT OF THE STATE OF CALIFORNIA

TOBACCO CASES.	
Including Actions:	
Cordova vs. Liggett Group, Inc.	San Diego Superior Court No. 651824
Ellis vs. R.J. Reynolds Tobacco Co.	San Diego Superior Court No. 706458
County of Los Angeles vs. R.J. Reynolds Tobacco Co.	San Diego Superior Court No. 707651
The People vs. Philip Morris, Inc.	San Francisco Superior Court No. 980864
The People ex rel. Lungren vs. Philip Morris, Inc.	Sacramento Superior Court No. 97AS 03031

MEMORANDUM OF UNDERSTANDING

(THIS PAGE INTENTIONALLY LEFT BLANK)

This Memorandum of Understanding ("MOU") is entered into by and among counsel representing plaintiffs The People of the State of California, the City and County of San Francisco, the City of Los Angeles and the City of San Jose, and the Counties of Alameda, Contra Costa, Marin, Riverside, Sacramento,. San Bernardino, San Diego, San Mateo, Santa Barbara, Santa Clara, San Luis Obispo, Shasta, Monterey, Santa Cruz and Ventura; the American Cancer Society, California Division; the American Heart Association, California Affiliates; the California Medical Association; the California District of the American Academy of Pediatrics; Julia L. Cordova; the County of Los Angeles and Zev Yaroslavsky; and James Ellis and Gray Davis, in their coordinated action against the tobacco industry.

WHEREAS the following actions were brought:

1. Cordova v. Liggett Group, Inc., San Diego Super. Ct. No. 651824 (filed May 12, 1992).

Plaintiff: Julia L. Corodva, a private individual suing on behalf of the general public. Cordova, Second Amended Complaint, ¶6.

Plaintiff's Counsel: Milberg Weiss Bershad Hynes & Lerach LLP, in association with three other law firms. Id. at 1.

Defendants: Philip Morris, Reynolds, Brown &Williamson, Lorillard, TI, CTR, United States Tobacco Company, Hill & Knowlton, Inc., Liggett Group, Inc. Id.

Factual Allegations: Defendants engaged in a decades-long conspiracy to deceive the public about the. health risks of smoking and the "addictive" nature of nicotine, and suppressed the development of "safer" cigarettes. Id. ¶¶20-74.

Causes of Action: The complaint consists of two causes of action for violations of California's Unfair Competition Act codified at Bus. & Prof. Code §§17200 et seq. ("UCA"). Id. ¶¶75-85.

Relief Requested: Disgorgement of "hundreds of millions of dollars" in "ill-gotten gains"; prohibitory and mandatory injunctive relief. Id. ¶¶79, 80(c)-(d), 83, 85(c)-(d); id. at 47.

Judge: The Honorable Robert E. May.

State of Pleadings: Settled.

Trial Date: February 5, 1999. Order Setting Trial; at 2 (San Diego Super. Ct. Aug. 8, 1997).

2. Ellis v. R.J. Reynolds Tobacco Co., San Diego Super. Ct. No. 706458 (filed July 24, 1996; refiled after voluntary dismissal, on Dec. 17, 1996).

Plaintiffs: James Ellis and Gray Davis, suing as private individuals on behalf of the general public. Ellis, Third Amended Complaint, ¶4.

Plaintiffs' Counsel: Robinson, Calcagnie & Robinson in association with a number of other firms. Id. at 1.

Defendants: Philip Morris, Reynolds, Brown &Williamson, Lorillard, TI, CTR, B.A.T. Industries p.l.c., British American Tobacco Company, Ltd., Batus Holdings, Inc., Batus, Inc., Liggett & Myers. Id.

Factual Allegations: Defendants engaged in a decades-long conspiracy to deceive the public about the health risks of smoking and the "addictive" nature of nicotine (id. ¶¶1, 23-60), suppressed the development of "safer" cigarettes (id. ¶¶154-79),

wrongfully manipulated nicotine levels in cigarettes (id. ¶1), and intentionally marketed their products to minors (id. ¶¶209-44).

Causes of Action: The complaint consists of two causes of action for violations of the UCA. Id. ¶¶253-64.

Relief Requested: Disgorgement of "hundreds of million: of dollars" in "ill-gotten gains" (id. ¶¶256-57, 263-64) prohibitory injunctive relief (id. at 81-82); and mandatory injunctive relief requiring (1) disclosure of all research relating to smoking, health, and addiction, (2) funding of smoking-cessatior programs, and (3) disclosure of nicotine yields of all products (id. at 82).

Judse: The Honorable Robert E. May.

State of Pleadinss: Settled.

Trial Date: February 5, 1999. Order Setting Trial, at 2 (San Diego Super. Ct. Aug. 8, 1997).

3. County of Los Angeles v. R.J. Reynolds Tobacco Co., Sar Diego Super. Ct. No. 707651 (filed Aug. 5, 1996).

Plaintiffs: Los Angeles County Supervisor Zev Yaroslavsky, on behalf of the general public, and the County of Los Angeles. County of Los Angeles, Fifth Amended Complaint, ¶3.

Plaintiffs' Counsel: Robinson, Calcagnie & Robinson, in association with a number of other firms. Id. at 1.

Defendants: Philip Morris, Reynolds, Brown &Williamson, Lorillard, TI, CTR, B.A.T. Industries p.l.c., British American Tobacco Company, Ltd., Liggett & Myers, Inc. Id.

Factual Allegations: Defendants engaged in a decades-long conspiracy to deceive the public about the health risks of smoking and the "addictive" nature of nicotine (id. ¶¶1, 23-59).

suppressed the development of "safer" cigarettes (id. ¶¶153-78), wrongfully manipulated nicotine levels in cigarettes (id. ¶¶198-206), and intentionally marketed their products to minor (id ¶¶208-43).

Causes of Action: The complaint consists of two causes of action for violations of the UCA (id. ¶¶257-63), one cause of action for violations of the False Advertising Law codified at Bus & Prof. Code §§17500 et seq. ("FAL") (id. ¶¶264-68), and claims for negligence, strict liability, fraud, and breach of warranty (id. ¶¶269-302).

Relief Requested: The UCA and FAL causes of action seek disgorgement of "hundreds of millions of dollars" in "ill-gotter gains" (id. ¶¶255-56, 263, 268), prohibitory injunctive relief (id. at 94), and mandatory injunctive relief requiring (1) disclosure of all research relating to smoking, health and addiction, (2) funding of smoking-cessation programs, (3) disclosure of nicotine yields of all products, and (4) cessation of advertising campaigns allegedly targeting minors (id. at 94-95). The causes of action for negligence, strict liability, breach of warranty, and fraud seek money damages in the amount of the County's health-care expenditures for alleged smoking-related illnesses. Id. at 96.

Judge: The Honorable Robert E. May.

State of Pleadings: Settled as to UCA and FAL.

Trial Date: February 5, 1999 (as to the UCA and FAL claims) The causes of action seeking to recoup health-care expenditures are scheduled to be tried at some date after February 5, 1999

4. People v. Philip Morris, Inc., San Francisco Super. Ct. No. 980864 (filed Sept. 5, 1996).

Plaintiffs: The City and County of San Francisco, seventeen other cities and counties on behalf of the People of the State of California and four medical organizations. People, Second Amended Complaint, ¶¶6-10.

Plaintiffs' Counsel: Louise Renne, the City Attorney for the City and County of San Francisco, Lieff, Cabraser, Heimann & Bernstein, LLP and Milberg Weiss Bershad Hynes & Lerach LLP.

Defendants: Philip Morris, Reynolds, Brown & Williamson, Lorillard, TI, CTR. People, Second Amended Complaint, at 1.

Factual Allegations: Defendants engaged in a decades-long conspiracy to deceive the public about the health risks of smoking and the "addictive" nature of nicotine (id. ¶¶1-3, 130-71), suppressed the development of "safer" cigarettes (id. ¶¶2, 72-93), wrongfully manipulated nicotine levels in cigarettes (id. ¶¶1, 98-101), and intentionally marketed their products to minors (id. ¶¶1, 104-37).

Causes of Action: The complaint consists of three causes of action for violations of the UCA and one cause of action for violation of the FAL. Id. ¶¶141-64.

Relief Requested: Disgorgement of "all profits" acquired by means of the alleged conduct (id. at 46); civil penalties (id.); prohibitory injunctive relief (id. at 45); and mandatory injunctive relief requiring (1) disclosure of all research relating to smoking, health, and addiction; (2) funding of smoking-cessation programs; (3) disclosure of nicotine yields of all products; (4) cessation of advertising campaigns allegedly targeting minors;

and (5) the funding of a "corrective public education campaign" (id. at 46).

Judge: The Honorable Paul H. Alvarado.

State of Pleadings: Settled

Trial Date: March 1, 1999. Minute Order ¶1 (San Francisco Super. Ct. Apr. 28, 1997).

5. People ex rel. Lungren v. Philip Morris, Inc. (the "AG case"), Sacramento Super. Ct. No. 97 AS 03031 (filed June 12, 1997)

Plaintiffs The People of the State of California ex rel. Daniel E. Lungren, Attorney General of the State of California and S. Kimberly Belshe, Director of Health Services of the State of California. AG, First Amended Complaint, ¶¶1-2.

Plaintiffs' Counsel: The Attorney General of the Stat of California. Id. at 1.

Defendants: Philip Morris, Reynolds, Brown & Williamson, Lorillard, CTR, TI, B.A.T. Industries p.l.c., United States Tobacco Company, Smokeless Tobacco Council, Inc., British American Tobacco Company, Hill & Knowlton, Inc. Id.

Factual Allegations: Defendants engaged in a decades-long conspiracy to deceive the public about the health risks of smoking and the "addictive" nature of nicotine (id. ¶¶26-48), suppressed the development of "safer" cigarettes (id. ¶¶36-43), wrongfully manipulated nicotine levels in cigarettes (id. ¶¶47, 59, 60, 69), intentionally marketed their products to minors (id. ¶¶48-54), and knowingly making false claims or statements to avoid fines and penalties for violations of statutes. (Id. ¶¶26-54)

Causes of Action: The complaint consists of one cause of action for violations of the UCA (id. ¶¶82-82), one cause of action for recovery of Medi-Cal costs (id. ¶¶56-69), and one cause of action for violation of the Cartwright Act (id. ¶¶70-74) and one cause of action for violations of the False Claims Act. (Id. ¶¶75-80).

Relief Requested: Prohibitory injunctive relief (id. at 23-24); civil fines and penalties under the UCA and the California False Claims Act (Cal. Gov't Code §§12650-12655) (id. at 24); and damages equivalent to the State's Medi-Cal expenditures for alleged smoking-related illnesses for the last three years (id. at 23).

Judge: The Honorable John R. Lewis (for law and motion matters)

State of Pleadings: As to UCA and predicate antitrust claims settled.

Trial Date: The court has not set a trial date. However, the court has ordered that the case be disposed of by August 31, 2000.

WHEREAS, provided trial of the cases is not materially delayed, the parties agree that the cases should be coordinated and consolidated for a single trial of all of the UCA and FAL claims because coordination and consolidation will promote the ends of justice.

WHEREAS, the undersigned parties acknowledge the coordination of civil actions sharing a common question of fact or law is appropriate where "one judge hearing all of the actions for all purposes will promote the ends of justice." Cal. Civ. Proc. Code §404.1. The determination of whether coordination will

"promote the ends of justice," involves the consideration of the following factors set forth in Code of Civil Procedure §404.1, these factors are: (1) "whether the common question of fact or law is predominating and significant to the litigation;" (2) "the convenience of parties, witnesses, and counsel"; (3) "the relative development of the actions and the work product of counsel"; (4) "the efficient utilization of judicial facilities and manpower"; (5) "the calendar of the courts"; (6) "the disadvantages of duplicative and inconsistent rulings, orders, or judgments"; and (7) "the likelihood of settlement of the action without further litigation should coordination be denied." The parties agree that these five actions satisfy the above conditions.

WHEREAS, these cases present significant and predominating common questions of fact and law. All five of the cases seek to determine whether aspects of the tobacco industry defendants' research, manufacturing, and marketing practices over the last forty years constitute unfair competition, an illegal combination in violation of antitrust laws and whether the people of California are entitled to relief. In all of the cases, the courts will confront similar factual questions including:

Whether the Tobacco Industry misrepresented or concealed facts known to them about the health risks of smoking

Whether the Tobacco Industry misrepresented or concealed information about the "addictive" nature of nicotine

Whether California consumers were deceived or likely to be deceived by misstatements or the concealment of facts about health and smoking by the Tobacco Industry

Whether the Tobacco Industry "manipulated" nicotine content or delivery of nicotine in their products

Whether the Tobacco Industry acted in concert to suppress development of a "safer" cigarette, and the effects of any such coordinated action

Whether the Tobacco Industry violated state antitrust laws

Whether the marketing practices of the cigarette companies deliberately or unfairly targeted or induced minors to smoke

WHEREAS the initial trial of the UCA and FAL claims involve many significant identical legal questions including:

- Whether the Tobacco Industry's conduct amounts to an "unfair" business practice within the meaning of the UCA
- Whether the Tobacco Industry's conduct amounts to an "unlawful" business practice within the meaning of the UCA
- Whether the Tobacco Industry's conduct amounts to a "fraudulent" business practice within the meaning of the UCA
- Whether the Tobacco Industry's conduct amounts to an illegal combination in violation of the Carwright Act and the UCA
- Whether the Tobacco Industry's conduct amounts to false or deceptive advertising within the meaning of the FAL.
- Whether any applicable statute of limitations has barred any claims wherein an ongoing conspiracy has been charged

WHEREAS, the convenience of parties, witnesses, and counsel will be served by coordination between the parties and discovery can be freely exchanged with the additional manpower focused on discrete areas to ensure proper preparation of the coordinated actions for trial.

WHEREAS by centralizing the actions in a single court, a coordinated action will preserve judicial resources.

WHEREAS, coordination by the parties helps in the overall-preparation for trial and may improve the chances for resolving these cases prior to trial, or otherwise obtaining significant

monetary and public health relief. Further, the actions we--e ordered coordinated. See Order Re: Coordination No. JCCP4041.

NOW, THEREFORE, it is agreed as follows:

1. EXECUTIVE COMMITTEE: An Executive Committee will be formed to review, consider and make all significant and/or material decisions in the litigation. The Executive Committee will consist of a representative from the Attorney General's office, Milberg Weiss Bershad Hynes & Lerach LLP, Lieff, Cabraser, Heimann & Bernstein LLP, Robinson, Calcagnie & Robinson, the City Attorney's office for the City and County of San Francisco and Los Angeles County Counsel. Each member of the Executive Committee shall play a significant role in the trial of this matter. The Attorney General is hereby designated by the Executive Committee as liaison counsel pursuant to California Rules of Court, Rule 1541.

2. **FUNDING OF EXPENSES**: The undersigned parties agree to share Funding of Expenses with each of the following entities responsible for one quarter of the expenses: The Attorney General's office, Milberg Weiss Bershad Hynes & Lerach LLP, Lieff, Cabraser, Heimann & Bernstein, LLP, and Robinson, Calcagnie & Robinson. To that end, an initial fund of $500,000 shall be established with each of the above entities placing $125,000 into the fund. The fund shall be established in the city in which the action is coordinated.

3. SHARING OF INFORMATION: The undersigned parties shall provide full and complete access to each other of all material in the respective possession or control with respect to the coordinated claims.

4. **PROTECTION OF CONFIDENTIAL INFORMATION**: The undersigned parties recognize that there is a mutuality of interest in the

common representation of their respective claims and that it is in the parties interest to share information. The parties agree to continue to pursue their common interests and to avoid any suggestion of waiver of privileged communications. Accordingly, it is the parties' intention and understanding, and they hereby agree, that communications of information and joint interviews among the parties in connection with the UCA, antitrust and FAL claims are confidential and are protected from disclosure to any third party by the attorney-client privilege and the work-product doctrine. The parties agree that all information, documents or materials, including, but not limited to, all client and witness statements, interviews conducted separately or jointly by the parties, memoranda of law, debriefing memoranda, factual summaries, transcript digests, and other such materials and information which would otherwise be protected from disclosure to third parties (hereinafter referred to as "Confidential Material"), and which are exchanged among any of the parties pursuant to this agreement, shall remain confidential and protected from disclosure to any third party by the attorney-client privilege and the work-product doctrine.

Further, because the exchange of Confidential Material is essential to the effective representation of the parties, the parties believe that the Confidential Material is protected by the attorney-client privilege and the attorney work-product doctrine. The exchange of Confidential Material pursuant to this Agreement is not intended to waive any attorney-client privilege or work-product protection otherwise available. Moreover, any inadvertent or purposeful disclosure of Confidential Material exchanged pursuant

to this Agreement which is made by a party to this Agreement shall not constitute a waiver of any privilege or protection of any other party to the Agreement. The Agreement applies equally to Confidential Material that has been exchanged or provided among the parties to date under an oral understanding consistent with the terms of this Agreement.

5. ALLOCATION BETWEEN LEGAL CLAIMS: In the event of recovery either by judgment after trial or by settlement, including a resolution of claims through federal legislation, it is the reasoned opinion of all parties to this agreement based on the current status and viability of all claims currently pending against the tobacco defendants when balanced against the claims that are currently on appeal, that 100% of the recovery shall be allocated to the UCA, antitrust and FAL claims.

6. ALLOCATION OF ANY RECOVERY:

a. The recovery, as allocated to the UCA, Antitrust and FAL claims, shall be exclusively divided between the state, cities and counties as follows:

i. 50% of the total recovery to the State of California.

ii. 50% of the total recovery to the cities and counties of California. Direct recovery to cities shall be restricted to cities whose city attorneys could have maintained an independent action under Business and Professions Code section 17204 to wit: Los Angeles, San Diego, San Francisco and San Jose (hereinafter the "eligible cities") . The recovery to the cities and counties shall be distributed as follows: ten percent (10%), distributed equally to the eligible cities (2.5% each) on a yearly

basis; the remaining ninety percent (90%) distributed yearly to the 58 counties within the State of California, on a per capita basis, calculated using the most current official United States Census numbers. In the event of a settlement of the State of California's claims, the sharing of the recovery by eligible cities and the counties will be conditioned upon a release by each city and county of all tobacco related claims consistent with the extent of the state's release and a dismissal with prejudice of any city or county's pending action. The monies payable under this agreement to settle the claims of the state, cities and/or counties shall be payable directly or through a qualified settlement fund pursuant to Section 468B of the Internal Revenue Code of 1986, and Treas. Reg. Section 1.468B or any similar tax exempt equivalent set up specifically for the purpose of making payments to each of these entities based on the formula agreed upon herein. Further, any monies the state, cities or counties receive under the provisions of this MOU are independent of any federal, state or other monies the participating state, city or county would otherwise receive and shall not be considered a recovery or reimbursement of any federal monies. In the event a city or county chooses not to participate in a settlement, and opts instead to pursue its respective litigation, that entity agrees not to share in the recovery pursuant to the distribution set forth in this MOU. In such case, that portion of the total recovery that would otherwise have been allocated to that entity shall be allocated 50% to the state, and 50% to the remaining cities and counties, in accordance with the allocation formula set forth above. Should any city or county choose not to participate in a settlement and elect instead to

pursue its respective litigation against the settling defendant-, any final judgment, from which no appeal may be taken, obtained by the city or county in such litigation may be credited against the amounts to be paid by the settling defendants to the state and the participating cities and counties under the terms of such settlement and this MOU.

iii. In the event the federal government asserts a claim over any monies obtained through a settlement, judgment or other recovery against the tobacco product manufacturers or otherwise acts to reduce the amount it provides the State of California under 42 U.S.C. §1396b(d) (2) (B) on account of any monies received pursuant to a recovery against the tobacco product manufacturers, such reduction shall be borne proportionally by the state and the cities and counties that will receive a distribution as proposed under this MOU. This event may be triggered at any time, and the parties agree that no restriction shall be imposed on the timing, frequency or amount of such adjustments as between the state and the cities and counties, and that such adjustments shall apply retroactively or prospectively as the need arises by virtue of federal action, but that any such adjustment shall be confirmed by the court where the consent decree in entered.

iv. The distribution of funds pursuant to this MOU is not subject to alteration by legislative, judicial or executive action at any level. If such action occurs and alters the distribution of these funds pursuant to this MOU, and survives all legal challenges to it, the distribution of these funds shall be nodified to offset such action and shall be bourne proportionally by the state and the cities and counties.

7 ATTORNEYS FEES:

a. Government Attorneys Fees and Costs -- It is contemplated that a settlement of the State of California's claims may provide for the reimbursement of the Office of the Attorney General and other appropriate agencies of the state, cities or counties, including city attorneys, county counsel offices and the Department of Health Services for the reasonable costs and expenses incurred in connection with the litigation or resolution of pending tobacco related claims, excluding: (i) costs and expenses relating to lobbying activities, and (ii) fees and costs of outside counsel. Such reimbursement shall be calculated based upon hourly rates equal to the local market rate for private attorneys, paralegals, clerks, executives, analysts or other staff of equivalent experience and seniority. The attorney general, its appropriate agencies and participating political subdivisions shall provide appropriate documentation of all costs, expenses and attorneys' fees for which payment is sought, and shall be subject to audit. This reimbursement shall be paid separately and apart from any other amounts due pursuant to any settlement by the state. Further, to the extent a settlement does not provide for reimbursement (or provides for less than full reimbursement) to the above agencies, such reimbursement shall come off the top before any distribution of monies contemplated in §§6.a.i and ii. Finally, a one time payment of one million dollars ($1,000,000) shall be distributed to the "The False Claims Act Fund" (Government Code Section 12652 (j)) before any distribution of monies contemplated in §§6.a.i. and ii.

b. Private Outside Counsel --

i. The Attorney General of the State of California has not employed private outside counsel to assist in the Prosecution of The People ex rel. Lunsren vs. Philip Morris, Inc., Sacramento Superior Court No. 97AS03031.

ii. The following public entity or benefit cases have arrangements with private outside counsel to assist them in prosecuting their respective claims: Cordova v. Liggett Group, Inc., SDSC No. 651824 ("Cordova"); Ellis v. R.J. Reynolds Tobacco co.. SDSC No. 706458 ("Ellis"); County of Los Anseles v. R.J. Reynolds Tobacco Co., SDSC No. 707651 ("Los Angeles"); The People v. Philip Morris, Inc., SFSC No. 980564 ("San Francisco"). Private counsel representing these plaintiffs are sensitive to the issue of private counsel representing public parties in tobacco litigation and their appropriate compensation. While this agreement in no way abrogates, changes or attempts to modify any fee agreement private counsel may have, all private counsel in the above listed actions agree to the following procedures in seeking to obtain fees or enforce any fee agreements with their respective clients: In addition to using best efforts to recover fees from defendants, in the event of a settlement of the State of California's claims, and to the extent a city or county agrees to release its claims in return for its share in the recovery pursuant to this MOU, private outside counsel agree to seek fees, costs and expenses in accordance with any mechanism set up pursuant to such settlement. Private counsel seeking reimbursement shall provide appropriate documentation of their costs and expenses, and shall be subject to audit. Payments received pursuant to this mechanism shall be paid

separately and apart from any other amounts due pursuant to any settlement by the state and shall in no way go to reduce the state's recovery. Private counsel agree that any fees, expenses or costs recovered by private counsel in consideration for services to or representation of their public entity clients pursuant to such mechanism shall be deducted from any fees, costs or expense payable under fee agreements with their respective clients. All private counsel acknowledge that their fee service contracts are subject to Rule 4-200 of the Rules of Professional Conduct of the State Bar of California which bars members of the Bar from charging or collecting an unconscionable fee. The Attorney General asserts that any fee dispute between private counsel and their respective clients should be submitted to the trial judge in the manner of a Code of Civil Procedure 51021.5 proceeding. Private counsel agree that any fee dispute shall be submitted to the trial judge. Private counsel, however, do not agree that such submission be limited in the manner of a Code of Civil Procedure 51021.5 proceeding.

8. SETTLEMENT: Should any party enter into settlement discussions with defendants or their counsel, that party shall, to the extent possible and in a timely manner, inform the other parties of the scope and nature of the settlement discussions. In no event shall any party attempt to settle claims which that party has no legal authority to settle.

DATED : August 5, 1998

MILBERG WEISS BERSHAD
HYNES & LERACH LLP
PATRICK J. COUGHLIN

PATRICK COUGHLIN

600 West Broadway, Suite 1800
San Diego, CA 92101
Telephone: 619/231-1058

Counsel for Cordova and the People of the State of California, by and through the City and County of San Francisco et al.

LIEFF, CABRASER, HEIMANN
& BERNSTEIN, LLP
RICHARD M. HEIMANN

RICHARD M. HEIMANN

275 Battery Street, 30th Floor
San Francisco, CA 94111-3339
Telephone: 415/956-1000

Counsel for the People of the State of California by and through the City and County of San Francisco et al.

ROBINSON CALCAGNIE & ROBINSON
MARK P. ROBINSON,, JR.

MARK P. ROBINSON, JR.

28202 Cabot Road
Suite 200
Laguna Niguel, CA 92617
Telephone: 714/347-8855

Counsel for the County of Los Angeles and Zev Yaroslavsky

ATTORNEY GENERAL'S OFFICE
TOM GREENE

TOM GREENE

1300 I Street, Suite 125
P.O. Box 944255
Sacramento, CA 94244-2550
Telephone: 916/263-0805

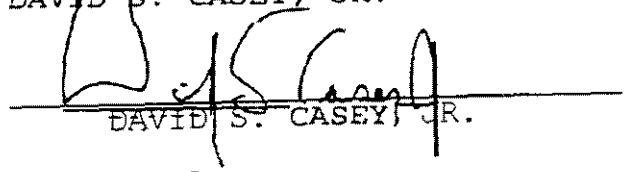
Counsel for The People of the State of California by and through the California Attorney General

THE OFFICE OF THE CITY ATTORNEY FOR THE CITY AND COUNTY OF SAN FRANCISCO

OWEN CLEMENTS

Fox Plaza, Sixth Floor
1390 Market Street
San Francisco, CA 94102-5408
Telephone: 415/554-3944

CASEY, GERRY, CASEY, ~~WESTBROOK,~~ REED & SCHNECK
DAVID S. CASEY, JR.



DAVID S. CASEY, JR.

110 Laurel Street
San Diego, CA 92101
Telephone: 619/238-1811

Counsel for James Ellis and Gray Davis

(THIS PAGE INTENTIONALLY LEFT BLANK)

AGREEMENT

REGARDING INTERPRETATION

OF

MEMORANDUM OF UNDERSTANDING

(THIS PAGE INTENTIONALLY LEFT BLANK)

AGREEMENT REGARDING INTERPRETATION
OF
MEMORANDUM OF UNDERSTANDING

TABLE OF CONTENTS

APPENDICES' PAGE REFERENCES

(THIS PAGE INTENTIONALLY LEFT BLANK)

AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING

WHEREAS, the parties hereto, the State of California and the Cities and Counties which become signatories to this Agreement Regarding Interpretation of the Memorandum of Understanding ("this Agreement"), agree that the terms as used herein shall have the meaning ascribed to them in Section 1 hereof; and

WHEREAS, the State and a number of California Cities and Counties, on August 5, 1998, entered into an agreement entitled "Memorandum of Understanding" (the "MOU") which is attached hereto as Appendix A; and

WHEREAS, on December 9, 1998, the Honorable Ronald Prager, Judge of the San Diego County Superior Court, as the Coordination Trial Judge in *In re Tobacco Cases I*, J.C.C.P. 4041, signed and entered a Consent Decree and Final Judgment as between the State of California and the Participating Manufacturers, which Final Judgment is attached hereto in its entirety as Appendix B and incorporates within it as Exhibit A thereto the settlement agreement entitled "Master Settlement Agreement" (the "MSA") which the Settling States, including the State of California, and the Participating Manufacturers entered into on November 23, 1998, and incorporates within it as Exhibit B the MOU; and

WHEREAS, pursuant to the MSA, the State is entitled to funds distributed through the National Escrow Agreement which was entered into on December 23, 1998, between the Settling States, including the State of California, and the Participating Manufacturers and the Escrow Agent, which is attached hereto as Appendix C; and

WHEREAS, pursuant to the National Escrow Agreement, Citibank, N.A., was appointed by the Settling States, including the State of California, and the Participating Manufactures to serve as the Escrow Agent under the terms and conditions set forth therein; and

WHEREAS, pursuant to the National Escrow Agreement, the Escrow Agent shall allocate the national tobacco settlement monies among accounts including State-Specific Accounts with respect to each Settling State, including the State of California, in which State-Specific Finality occurs, in accordance with written instructions from the National Independent Auditor; and

WHEREAS, pursuant to the MSA, upon the occurrence of State-Specific Finality in California, the California portion of the monies deposited by the Participating Manufacturers in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, and the Subsection IX(c)(2) Account (as such accounts are defined in the National Escrow Agreement) shall be transferred to a State-Specific Account designated by the MSA as the account for the State of California ("California Account"); and

WHEREAS, pursuant to the MSA, after Final Approval, the Independent Auditor shall instruct the Escrow Agent to disburse the funds held in the California Account to (or as directed by) the State; and

WHEREAS, pursuant to the MSA, to the extent that a payment is made to the California Account after the occurrence of all applicable conditions for the disbursement of such payment to the State, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit; and

WHEREAS, pursuant to the MOU, certain Cities and all Counties in California, upon meeting the conditions set forth in the MOU, are entitled to 50% of all funds transferred to the California Account, designated as the State-Specific account for the State of California distributed by virtue of the MSA; and

WHEREAS, the parties hereto recognize that issues may arise as to the proper interpretation of the MOU and such parties desire to: (i) set forth their understanding of the interpretation to be given to the terms the MOU; and (ii) establish a procedure for the expeditious resolution of any future disputes that may arise as between any of them as to the proper interpretation of the MOU and/or this Agreement; and

WHEREAS, the parties hereto have agreed that if judicial interpretation of the MOU or this Agreement becomes necessary, it is important that a single court within the State of California adjudicate all disputes between the parties as to the meaning and proper interpretation of the MOU and/or this Agreement:

NOW, THEREFORE, in consideration of the premises and the mutual promises contained in the MOU and this Agreement, the parties hereto agree as follows:

SECTION 1.
DEFINITIONS.

A. All terms herein have the same meaning as, and are defined the same as they are defined in the MSA unless specifically modified in Section 1.B hereof. All definitions contained in the MSA entered on November 23, 1998, are incorporated by reference herein in this Agreement.

B. As used in this Agreement, the following terms have the following meanings:

(1) The term "Agreement" or "this Agreement" means this Agreement Regarding Interpretation Of Memorandum Of Understanding.

(2) The term "book value" means the net amount at which a portfolio is shown in the accounting records.

(3) The term "California Account" means the State-Specific Account with respect to California which is established after California State-Specific Finality has occurred as referenced by Section 3(b) of the National Escrow Agreement.

(4) The term "City/County Steering Committee" means the City and County of San Francisco, the City of Los Angeles, the City of San Jose, the County of Santa Clara, the County of Santa Barbara and the County of Los Angeles.

(5) The term "City Designee," "County Designee," "City and County Designees" and/or "City Designees/County Designees" means, individually or collectively, the person(s) designated by each individual Eligible City and Eligible County to receive any notifications or statements and/or to provide any transfer or disbursement instructions.

(6) The term "City" or "Cities" means, individually or collectively, the City of Los Angeles, the City of San Diego, the City of San Francisco and the City of San Jose.

(7) The term "County" or "Counties" means, individually or collectively, the 58 counties of California.

(8) The term "City/County Dispute Resolution Court" means the J.C.C.P. 4041 Court.

(9) The term "Eligible City," "Eligible County," "Eligible Cities and/or Eligible Counties" and/or "Eligible Cities/Eligible Counties" means, individually or collectively, those Cities and Counties who because they have satisfied all requirements under the MOU and this Agreement are entitled to receive a portion of tobacco settlement monies which are transferred to the California Account as provided by the MSA, the MOU and this Agreement. To achieve the status of Eligible City or Eligible County, each City or County must:

(a) Execute one original "Model Release," attached hereto as Appendix "D" (or such other form of release that the City/County Dispute Resolution Court determines satisfies the release requirements of Section 6.a.ii of the MOU), and provide the executed original Release to the State; and

(b) Execute one original of this Agreement and provide the executed original to the State; and

(c) Execute one original "Authorization and Designation of City/County Designees," attached hereto as Appendix "E," and provide the executed original to the State; and

(d) Execute one original "Transfer Instructions " in the form attached hereto as Appendix "F," and provide the executed original to the State; and

(e) Execute one original Form W-9, attached hereto as Appendix "G," and provide the executed original to the State.

The address to which the above identified executed original documents are to be sent by each City and/or County seeking to become an Eligible City and/or Eligible County is set forth in Appendix "H."

(10) The term "J.C.C.P. 4041 Court" means the San Diego County Superior Court that presided over *In Re Tobacco Cases I*, Judicial Council Coordination Proceeding No. 4041.

(11) The term "Memorandum of Understanding" or "MOU" means the agreement entered between the State and certain Represented Cities and Counties on August 5, 1998, which is attached hereto as Appendix A.

(12) The term "MOU Proportional Allocable Share" means that portion of the Tobacco Settlement Proceeds to be transferred to the California Account as provided for by the MSA and then received by the State and Cities and Counties, in the percentages set forth in Section 6 of the MOU.

(13) The term "mark-to-market" means the value of a portfolio at current market prices.

(14) The term "Official United States Decennial Census" means the census taken every ten years by the federal government, but such census does not become the "Official United States Decennial Census" for the purposes of the MOU and this Agreement until such time as it is presented to the Governor of the State of California. If the United States Decennial Census is presented to the Governor of the State of California within the 30 days immediately prior to the date the State is to give notice pursuant to Section 3.K of this Agreement, it shall not be treated as the "Official United States Decennial Census" until after the transfer which is the subject of such notification has been made.

(15) The term "Represented City," "Represented County" and/or "Represented Cities and Counties" means individually or collectively, the City and County of San Francisco, the Cities of Los Angeles, San Diego and San Jose, and the Counties of Alameda, Contra Costa, Marin, Monterey, Orange, Riverside, Sacramento, San Bernardino, San Diego, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Shasta and Ventura that executed contingency fee contracts with private outside counsel to prosecute tobacco-related claims, and the County of Los Angeles who executed a separate contingency fee contract with private outside counsel to prosecute tobacco-related claims.

(16) The term "Responsible Entity" means the entity, whether the State or a City or County, that obtains a judgment or settlement which causes a claim-over as described in Section XII(a)(4) of the MSA.

(17) The term "State" means the State of California.

(18) The term "States" means those States and Commonwealths of the United States that signed the MSA.

(19) The term "Sub-Account(s)" means a sub-account or sub-accounts created in the California Account.

(20) The term "Tobacco Settlement Proceeds" or "Tobacco Settlement Monies" means the monies transferred to the California Account as provided by the MSA.

(21) The term "transfer" means the transfer of money among and to different Sub-Accounts of the California Account. It does not mean payment or disbursement as used in the National Escrow Agreement.

SECTION 2.
AGREEMENT AS TO THE PROPER COURT FOR INTERPRETATION OF THE MOU AND THIS AGREEMENT.

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the J.C.C.P. 4041 Court for purposes of any action or proceeding seeking to enforce any provision of, or based on any right arising out of, the MOU or this Agreement, and agree that they shall not commence any such action or proceeding except in the J.C.C.P. 4041 Court. The parties hereto agree that any dispute between or among the State, any Eligible City and/or any Eligible County shall be submitted by motion (or, if appropriate, by Ex Parte Application) to the J.C.C.P. 4041 Court, including any dispute regarding (i) the accurateness of any calculation pertinent to the allocation formula as described in Section 3.J of this Agreement, and/or (ii) the calculation or assessment of a Claim Over Offset Amount as described in Section 4.C of this Agreement. The parties hereto agree that any such decision by the J.C.C.P. 4041 Court shall be appealable, but that absent an appropriate Order any such appeal shall not delay any disbursement of any disputed amounts in accordance with the J.C.C.P. 4041 Court's decision. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such application, motion action or proceeding in the J.C.C.P. 4041 Court, and further irrevocably waive and agree not to plead or claim in the J.C.C.P. 4041 Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 3.
UNDERSTANDINGS REGARDING THE MSA AND THE MOU AS THEY RELATE TO THE RELEASE OF FUNDS PURSUANT TO THE MSA AND THE MOU PRIOR TO SATISFACTION OF ALL TERMS AND CONDITIONS OF SECTION 3.C OF THE NATIONAL ESCROW AGREEMENT.

A. Before such time as all events and conditions set forth in Section 3.C of the National Escrow Agreement have been satisfied and the funds are released to the States, all funds received by the Escrow Agent pursuant to the terms of the National Escrow Agreement shall constitute the "Escrow" and shall be held and disbursed in accordance with the terms of the National Escrow Agreement and this Agreement. In the event of a conflict, until such time as all events and conditions set forth in Section 3.C of the National Escrow Agreement have been satisfied and the Escrow Agent is notified to release the escrow funds to the States, the terms of the National Escrow Agreement shall govern over terms in the MOU or this Agreement. The State shall instruct the national Escrow Agent that such funds and any earnings thereon shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the State, the Cities and Counties and the Participating Manufacturers.

B. The Escrow Agent shall allocate the Escrow among the accounts referenced in the National Escrow Agreement (each one an "Account" and collectively the "Accounts") including the California Account in accordance with written instructions from the Independent Auditor.

C. Pursuant to Section 20 of the National Escrow Agreement, and in accordance with the MOU and this Agreement, the State shall instruct the Escrow Agent to allocate the money flowing into the California Account as follows:

(1) It is understood by the parties to this agreement that prior to the entry of an Order by the J.C.C.P. 4041 Court approving this Agreement, there will be two disbursements of Tobacco Settlement Proceeds pursuant to the MSA; the December 14, 1999, disbursement and the January 10, 2000, disbursement. It is therefore understood by the parties to this Agreement that:

(a) With respect to the December 14, 1999 disbursement, in accordance with the terms of the MOU, $1,000,000.00 was credited and transferred to the False Clams Act Fund. The remaining funds (after transfer of $1,000,000.00 to the False Claims Act Account) were credited 50% to the State and 50% to the Cities and Counties. The 50% of the funds credited to the State were transferred to the State General Fund at or about the time of the December 14, 1999 disbursement. At the time of disbursement, the 50% of the funds credited to the Cities and Counties were transferred to the "Tobacco Settlement Fund Account" maintained by the California Department of Justice, to be held on an interim basis for the exclusive benefit of the Cities and Counties until such time as the Court approves

this Agreement, and the City/County Account described in section 4.B.(2)(ii) of this Agreement is created.

(b) With respect to the January 10, 2000, disbursement, in accordance with the terms of the MOU, 50% of the funds will be credited to the State and 50% to the Cities and Counties. The 50% of the funds credited to the State will be transferred to the State General Fund at the time of the disbursement. At the time of disbursement, the 50% of the funds credited to the Cities and Counties will be transferred to the "Tobacco Settlement Fund Account" maintained by the California Department of Justice, to be held on an interim basis for the exclusive benefit of the Cities and Counties until such time as the Court approves this Agreement, and the City/County Account described in section 4.B.(2)(ii) of this Agreement is created. Any future disbursements that become available before the execution of this Agreement and a conforming escrow agreement between the State and the Escrow Agent shall be treated in the same manner.

(c) Upon approval of this Agreement by the J.C.C.P. 4041 Court and the execution of a conforming escrow agreement between the State and the Escrow Agent, all funds in the "Tobacco Settlement Fund Account" (including any interest generated thereon) shall be transferred to the City/County Account to be disbursed to the Eligible Cities and Eligible Counties in accordance with section 3.J this Agreement. However, each Eligible City and/or Eligible County may elect to have the State transfer its MOU Proportional Allocable Share (including any interest generated thereon) directly to such Eligible City and/or Eligible County without requiring such funds to be first transferred to the Escrow Agent.

(2) Upon approval by the J.C.C.P. 4041 Court of this Agreement and the execution of a conforming escrow agreement between the State and the Escrow Agent, all additional money that enters the California Account shall be allocated as follows:

(a) 50% of each dollar, or portion thereof, shall be credited to the State; and

(b) 50% of each dollar, or portion thereof, shall be credited to the Cities and Counties to be distributed in the manner set forth in Section 3.J hereof, unless the Escrow Agent receives different instructions from the State in the manner set forth by this Agreement.

D. All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of the National 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"). The Escrow Agent shall be entitled to rely upon the Independent Auditor's identification of the Settling States and the Subsequent Participating Manufacturers that contributed any amounts in an Account.

In the event of a conflict, instructions pursuant to subclause (ii) shall govern over instructions pursuant to subclause (i).

E. All amounts credited to a Sub-Account shall be retained in such Sub-Account until and unless transferred pursuant to written instructions received by the Escrow Agent from the State. However, the State shall not provide any instructions for a transfer which consists of a disbursement in violation of this Agreement or of the National Escrow Agreement.

F. It is understood by the parties to this Agreement that the MSA requires that on the First Business Day after each date identified to the Escrow Agent by the Independent Auditor in writing as a date upon which any payment is due under the MSA, the Escrow Agent shall deliver to each other Notice Party as defined in the MSA, and to those the State has designated in writing, a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment. As soon as practical after receipt of such information from the Escrow Agent, but in no event more than 24 hours after receipt or the next business day, which ever is later, of such information, the State shall give notice to each City Designee and County Designee of which the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the information the State has received from the Escrow Agent.

G. It is understood by the parties to this Agreement that the MSA requires that on the first Business Day after each transfer, the Escrow Agent shall deliver to the State a written statement showing the amount of such transfer, the source of the transfer, and the Sub-Account or Sub-Accounts to which such transfer has been credited. As soon as practical after receipt of such information from the Escrow Agent, but in no event more than 24 hours after receipt of such information or the next business day after receipt of such information, which ever is later, the State shall give notice to each City Designee and County Designee of whom the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the information it has received from the Escrow Agent.

H. It is understood by the parties to this Agreement that the MSA requires that the Escrow Agent shall comply with all payment instructions received from the Independent Auditor, unless before 11:00 a.m. (E.S.T.) on the scheduled date of payment the Escrow Agent receives written instruction to the contrary from the State in the manner set forth in this Agreement, in which event the Escrow Agent shall comply with such instructions. It is understood by the parties to this Agreement that instructions received after 11:00 a.m. (E.S.T.) will be treated as if received on the following Business Day.

I. It is understood by the parties to this Agreement that the MSA requires that the Escrow Agent shall comply with all transfer instructions received from the State unless before 11:00 a.m. (E.S.T.) on the day the transfer is to occur the Escrow Agent receives different written instruction from the State in which event it shall comply with such instructions. The State shall not provide any instructions to the Escrow Agent that contradict the terms of the MOU or the terms of this Agreement. It is understood by the parties to this Agreement that instructions received after 11:00 a.m. (E.S.T.) will be treated as if received on the following Business Day.

J. The State shall instruct the Escrow Agent that all funds in the California Account shall be disbursed in the manner set forth in Section 3.C of this Agreement. Thus, as set forth in the MOU, 10% of the funds to be credited to the Cities and Counties (i.e., 10% of the 50% of the Tobacco Settlement Proceeds) shall be allocated 2.5% each among the Eligible Cities, and 90% of the funds to be credited to the Cities and Counties (i.e., 90% of the 50% of the Tobacco Settlement Proceeds) shall be allocated among the Counties, on a per capita basis, calculated by using population data set forth for California Counties as reported in the most current Official United States Decennial Census. Assuming that each City and County which can become an Eligible City or Eligible County, in fact is an Eligible City or Eligible County, and unless otherwise modified by the State in accordance with Sections 4.B or 4.C of this Agreement, the transfer instructions given by the State to the Escrow Agent shall be in the form of the Model Escrow Instructions set forth as Appendix I which sets forth the model MOU Proportional Allocable Shares based on the official 1990 United States Decennial Census. The State shall make any necessary adjustments to the distribution percentages as they relate to this clause and the MOU promptly upon the issuance of each future Official United States Decennial Census. All parties to this Agreement realize that with each new Official United States Census the MOU Proportional Allocable Share to be received by each Eligible County will most likely change.

K. The State shall provide to the Escrow Agent, as far in advance of the next actual disbursement date as possible, the transfer instructions for the next transfer of funds from the California Account and shall provide at the same time to each Eligible City Designee and Eligible County Designee of whom the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the transfer instructions the State is providing to the Escrow Agent along with proof of service to the Eligible Cities and Eligible Counties of such transfer instructions.

SECTION 4.
UNDERSTANDINGS REGARDING THE MSA AND THE MOU AS THEY RELATE TO RELEASE OF FUNDS PURSUANT TO THE MSA AND THE MOU AFTER SATISFACTION OF ALL TERMS AND CONDITIONS OF SECTION 3.C OF THE NATIONAL ESCROW AGREEMENT.

A. After such time as all events and conditions set forth in Section 3.C of the National Escrow Agreement have been satisfied and the escrow funds are released to the California Account, the State shall instruct the Escrow Agent that all funds received by the Escrow Agent pursuant to the terms of the National Escrow Agreement shall be held and disbursed in accordance with the terms of the MOU and this Agreement. The State shall further instruct the Escrow Agent that such funds and any earnings thereon shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, other States, the Cities and Counties and the Participating Manufacturers.

B. Unless the Escrow Agent receives notification pursuant to Section 4.C of this Agreement:

(1) The funds credited to the State pursuant to Section 3.C.(2)(a) above, shall be disbursed to the State in accordance with transfer instructions to be provided by the State.

(2) The funds credited to the Cities and Counties pursuant to Section 3.C.(2)(b) above, shall be disbursed to the Eligible Cities and Eligible Counties in accordance with transfer instructions to be provided by the State, which shall be subject to the MOU and this Agreement as follows:

(i) If the Escrow Agent has received written notification from the State that a City or County has obtained the status of Eligible City and/or Eligible County, prior to the distribution from the California Account:

(aa) The State shall instruct the Escrow Agent to disburse each Eligible City's and/or Eligible County's MOU Proportional Allocable Share pursuant to instructions received by the State from the City Designees/County Designees as to which account such funds shall be directed. The instructions the State provides will direct the Escrow Agent to disburse each Eligible City's and/or Eligible County's Share to a single account specified by that Eligible City and/or Eligible County. This account information will be given in the form of executed Transfer Instructions attached hereto as Appendix F jointly executed by two of three such Eligible City's and/or Eligible County's respective City Designees/County Designees. Upon receipt of the executed Transfer Instructions from the Eligible City and/or Eligible County the State shall forward such information to the Escrow Agent within twenty four (24) hours of receipt or the next business day, which ever is later.

(bb) The instructions described in Section 4.B.(2)(i)(aa) above, may be modified from time to time by written amendment, which shall be given in a format specified by the State and shall be executed by two of the three City Designees/County Designees. Upon receipt of the change of the specified account information, and subject to verification by the State, the State shall forward such modified instructions to the Escrow Agent within seventy two (72) hours of receipt or within three business days, which ever is later.

(cc) The City Designees/County Designees may be substituted in either of the following ways: (i) By written amendment, which shall be given in a format specified by the State, and shall provide for additions and deletions of City Designee/County Designees. Substitution by this manner will only be given effect if it is signed by two of the three preexisting City Designees/County Designees; or (ii) By the City Council/County Board of Supervisors substituting the authorization provided for by Appendix E. Substitution by this manner must be done by a resolution of the City Council/County Board of Supervisors and must be done in the format as provided in Appendix E. In the event of a conflict between (i) and (ii) of this subparagraph, the State will follow the Designations as provided for by the City Council/County Board of Supervisors.

(ii) If the Escrow Agent has not received written notification from the State that a City or County has obtained the status of Eligible City and/or Eligible County prior to the first distribution from the California Account:

(aa) The State shall instruct the Escrow Agent to establish a single, interest bearing account into which the Escrow Agent transfers the MOU Proportional Allocable Share of each City and/or County for whom the Escrow Agent has not received written notification from the State that such City and/or County has obtained the status of Eligible City and/or Eligible County and shall instruct the Escrow Agent to provide to the State an accounting of the funds placed in such account, indicating the total amount placed therein and the amount placed therein which is being held for the benefit of each specific City and/or County. Within seventy-two (72) hours of receipt, or within three business days, which ever is later, of the accounting information, from the Escrow Agent, the State shall provide a copy of such information to the City/County Steering Committee. The Escrow Agent may charge each such City and/or County whose MOU Proportional Allocable Share is placed in such account, such City's and/or County's proportional share of the Escrow Agent's normal charges for establishing and maintaining such account (based on the percentage that such City's and/or County's MOU Proportional Allocable Share represents of the total amount in such account) through the date the Escrow Agent is notified by the State that such City and/or County has obtained the status of Eligible City or Eligible County and the Escrow

Agent may deduct such charges from the amount such City and/or County is due when the Escrow Agent is notified by the State that such City and/or County has obtained the status of Eligible City or Eligible County.

(bb) Any dispute between the State, the City/County Steering Committee, and/or any City and/or County as to whether a City and/or a County has obtained the status as an Eligible City and/or Eligible County shall be submitted to, and shall continue to be under, the jurisdiction of the J.C.C.P. 4041. The State shall instruct the Escrow Agent to deposit the MOU Proportional Allocable Share of any such City and/or County to which such dispute pertains into the City/County Account established pursuant to section 4.B.(2)(ii)(aa) of this Agreement. Any City and/or County that is adjudged by the J.C.C.P. 4041 Court to be an Eligible City and/or Eligible County pursuant to this subparagraph shall immediately notify the State of such ruling by providing the State with a copy of the order or judgment of the J.C.C.P. 4041 Court. The State within twenty four (24) hours, or the next business day, which ever is later, of receipt of such order or judgment of eligibility shall forward such eligibility information to the Escrow Agent. Any City and/or County that is adjudged by the J.C.C.P. 4041 Court not to be an Eligible City and/or Eligible County pursuant to this subparagraph shall have a 90 day grace period to cure any deficiency that has prevented it from becoming an Eligible City and/or Eligible County.

(cc) The State shall provide the Escrow Agent with additional instructions as follows: If prior to the later of June 30, 2001, or the expiration of any grace period specified in paragraph 4.B.(2)(ii)(bb) above, the Escrow Agent receives written notification from the State that such City and/or County has attained the status of Eligible City and/or Eligible County, the Escrow Agent shall promptly disburse to such newly Eligible City and/or Eligible County all funds representing such newly Eligible City's and/or Eligible County's MOU Proportional Allocable Share which had previously been placed in the separate City/County account established in accordance with Section 4.B.(2)(ii)(aa) (including any interest generated therefrom), after deducting the appropriate Escrow Agent's charges as allowed by such Section.

(dd) The State shall further instruct the Escrow Agent that upon receipt of notification from the State that such City and/or County has attained the status of Eligible City and/or Eligible County, all MOU Proportional Allocable Shares for such City and/or County which are to be disbursed after the date of notification that such City/County has obtained the status of Eligible City or Eligible County shall be disbursed to such Eligible City and/or Eligible County in accordance with Section 4.B.(2)(i).

(iii) If the Escrow Agent has not received written notification from the State that a City or County has obtained the status of Eligible City and/or Eligible County, by the later of June 30, 2001, or the expiration of any grace period specified in subparagraph (dd) below:

(aa) The State shall instruct the Escrow Agent that all funds previously placed in the City/County account pursuant to Section 4.B.(2)(ii)(aa) (including any interest generated therefrom), shall be deducted from such account and shall be transferred to the California Account, from which it is to be distributed to the State and the Eligible Cities and Eligible Counties in the manner set forth in Section 3.C.(2).

(bb) It is understood by the parties to this Agreement that until such time as the Escrow Agent receives notice from the State that such City and/or County has attained the status of Eligible City and/or Eligible County, all MOU Proportional Allocable Shares of any such City and/or County that are to be disbursed prior to the date of notification that such City/County has obtained the status of Eligible City or Eligible County shall continue to be disbursed to the State and to the Eligible Cities and Eligible Counties in accordance with Section 3.C.(2).

(cc) The State shall instruct the Escrow Agent that upon receipt of notification from the State that such City and/or County has attained the status of Eligible City and/or Eligible County, all MOU Proportional Allocable Shares for such City and/or County that are to be disbursed after the date of notification that such City/County has obtained the status of Eligible City and/or Eligible County, shall be disbursed to such Eligible City and/or Eligible County in accordance with Section 3.C.(2). Provided, however, that the parties to this Agreement, recognize that the State shall further instruct the Escrow Agent that if prior to attaining the status of Eligible City and/or Eligible County, a City and/or County obtains a settlement or judgment that causes a reduction of payments into the escrow account pursuant to Section XII(a)(4)(B) of the MSA and the amount of that reduction in payments exceeds the amount of escrow payments that the City and/or County in question has foregone pursuant to subparagraphs (aa) and (bb) directly above, then an amount equal to the reduction in escrow payments pursuant to section 6.a.ii of the MOU minus the amounts foregone by the City and/or County pursuant to subparagraphs (aa) and (bb) directly above shall be deducted from the future escrow payments owing which would otherwise be paid to the City and/or County in question and such amount(s) shall be transferred to the State and to the other Eligible Cities and/or Eligible Counties, in the same manner as the Claim Over Offset described in section 4.C below.

(dd) Any dispute between the State, the City/County Steering Committee, and/or any City and/or County as to whether a City and/or a County has obtained the status of an Eligible City and/or Eligible County shall be submitted to, and shall continue to be under, the jurisdiction of the J.C.C.P. 4041 Court. If any such dispute is submitted to the J.C.C.P. 4041 Court, the State shall instruct the Escrow Agent to deposit the MOU Proportional Allocable Share of any such City and/or County to which such dispute pertains into the City/County Account established pursuant to section 4.B.(2)(ii)(aa) of this Agreement. The State shall not submit any additional instructions regarding the disbursement of such funds while a dispute as to eligibility is pending before the J.C.C.P. 4041 Court. Any City and/or County that is adjudged by the J.C.C.P. 4041 Court to be an Eligible City and/or Eligible County pursuant to this subparagraph (dd) shall immediately notify the State of such ruling by providing the State with a copy of the order or judgment of the J.C.C.P. 4041 Court. The State within twenty four (24) hours of receipt or the next business day, which ever is later, of such order or judgment of eligibility shall forward such eligibility information to the Escrow Agent and instruct the Escrow Agent to disburse all funds allocated to such newly Eligible City or newly Eligible County. Any City and/or County that is adjudged by the J.C.C.P. 4041 Court not to be an Eligible City and/or Eligible County pursuant to this subparagraph (dd) shall have a 90 day grace period to cure any deficiency that has prevented it from becoming an Eligible City and/or Eligible County.

(iv) The State shall instruct the Escrow Agent that it is not to disburse funds to any City or County that has not attained the status of Eligible City or Eligible County.

(v) Upon obtaining the status of Eligible City or Eligible County, each Eligible City and each Eligible County shall, if it has not already done so, notify the State of the names and addresses of their City Designees and County designees.

(vi) The State shall provide to the Escrow Agent, as far in advance of the next actual disbursement date as possible, the transfer instructions for the next transfer of funds from the California Account and shall provide at the same time to each Eligible City Designee and Eligible County Designee of whom the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the transfer instructions the State is providing to the Escrow Agent.

C. In the event that Section XII(a)(4)(A) of the MSA does not relieve an Original Participating Manufacturer of all liability and Section XII(a)(4)(B) of the MSA is invoked resulting in an Original Participating Manufacturer receiving 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 any Original Participating Manufacturer) on any liability against such Original Participating Manufacturer's share, determined as described in step E of Section IX(j)(7)(E) of the MSA, owing to the State (and because of the MOU, to the Cities and Counties), 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 ("Claim Over Offset Amount"), it is the intent of the State and the Cities and Counties that the California Account be operated so as to be reflective of the rights and duties of the State and the Eligible Cities and Eligible Counties under the MOU, and that, in accordance with the MOU, all benefits and burdens that affect the California Account, or affect how the money in the account may be spent, will be borne equally by the State on one hand, and the Eligible Cities and Eligible Counties on the other. (The State shall inform the Escrow Agent of such intent of the parties to this Agreement.) If the actions described above in this paragraph occur:

(1) The State shall notify the Escrow Agent, the City/County Steering Committee, and the Responsible Entity that Section XII(a)(4)(B) of the MSA has been invoked, and provide the Escrow Agent, the City/County Steering Committee, and the Responsible Entity with written instructions stating the Claim Over Offset Amount and the identity of the Responsible Entity and instruct the Escrow Agent as follows:

(a) That the amounts otherwise allocable to the Responsible Entity shall thereafter be reduced dollar-for-dollar until the full Claim Over Offset Amount has been deducted from the MOU Proportional Allocable Share owed to the Responsible Entity. These adjustments to the allocation set forth under this Agreement are done with the understanding of the State and the Cities and Counties that the Responsible Entity will have its MOU Proportional Allocable Share likewise reduced dollar-for-dollar until the full Claim Over Offset Amount of the Original Participating Manufacturer's share owing to the State, and because of the MOU to the Cities and Counties (other than the Responsible Entity), which has been offset by the Original Participating Manufacturer, has been deducted from the MOU Proportional Allocable Share owing to the Responsible Entity and the amount deducted from the MOU Proportional Allocable Share owing to the Responsible Entity has been distributed, pursuant to the terms of the MOU, to the State and the other Eligible Cities and Eligible Counties which did not bring the original action against the non-Released Party or non-Released Retailer.

(b) That the Responsible Entity shall be responsible for the interest on the Claim Over Offset Amount at the annual rate equal to the available daily rate of return earned by the California Pooled Money Investment Account from the actual date of disbursal of the reduced share to the State and to the Eligible Cities and Eligible Counties. The amount deducted from the Responsible Entity's MOU

Proportional Allocable Share shall be distributed 50% to the State and 50% to the Eligible Cities and Eligible Counties (other than the Responsible Entity). Interest owed is determined from the date the funds are released to the date of actual disbursal to the State/Eligible Cities/Eligible Counties.

(2) If a member of the City/County Steering Committee or the entity the State has identified as the Responsible Entity does not take action as described in section 4.C.(3) below to contest the amount the State has identified as the appropriate Claim Over Offset Amount and/or to contest the State's identification of the correct Responsible Entity, the following shall occur:

(a) If the Claim Over Offset Amount is less than the MOU Proportional Allocable Share of the Responsible Entity, the State shall instruct the Escrow Agent that the Claim Over Offset Amount shall be deducted and credited as follows:

(i) If the Responsible Entity is the State, in the manner set forth in the mathematical example attached hereto as Appendix J, to wit:

(aa) An amount equal to one-half of the offset shall be deducted from the State's 50% share and shall be credited to the Cities'/Counties' 50% share.

(bb) Any amounts credited to the Cities'/Counties' share pursuant to this subparagraph shall be allocated among and disbursed to the Eligible Cities and Eligible Counties as provided in Section 3.J of this Agreement and the State, in notifying the Escrow Agent of distribution amounts to be made to the State and to each Eligible City and Eligible County, shall modify the instructions it gives to the Escrow Agent to accurately reflect such deductions and credits.

(ii) If the Responsible Entity is a City or County, in the manner set forth in the mathematical example attached hereto as Appendix K, to wit:

(aa) An amount equal to one-half of the offset shall be deducted from the Responsible Entity's MOU Proportional Allocable Share and shall be credited to the State share.

(bb) After making the deduction described in paragraph (aa), the remaining one-half of the offset shall be deducted from the Responsible Entity's MOU Proportional Allocable Share, and shall be reallocated to each Eligible City and Eligible County (including

the Responsible Entity) pursuant to its MOU Proportional Allocable Share in the manner provided in Section 3.J of this Agreement. The State, in notifying the Escrow Agent of distribution amounts to be made to the State and to each Eligible City and Eligible County, shall modify the instructions it gives to the Escrow Agent to accurately reflect such deductions and credits.

(b) If the Claim Over Offset Amount is equal to or greater than the MOU Proportional Allocable Share of the Responsible Entity, the State shall instruct the Escrow Agent that such Claim Over Offset Amount shall be deducted and credited as follows:

(i) If the Responsible Entity is the State, in the manner set forth in the mathematical example attached hereto as Appendix L, to wit:

(aa) The entire MOU Proportional Allocable Share of the State shall be credited to the Cities'/Counties' share until the Claim Over Offset Amount has been repaid in full, including interest as described in Section 4.C.(1)(b) of this Agreement.

(bb) Once any remaining Claim Over Offset Amount, including any interest as described in Section 4.C.(1)(b), is less than the Responsible Entity's MOU Proportional Allocable Share during any payment period, Section 4.C.(2)(a) shall govern distribution and allocation.

(cc) Any amounts credited to the Cities'/Counties' share pursuant to this Section 4.C.(2)(b) shall be disbursed among the Cities and Counties as provided in Section 3.J of this Agreement.

(dd) The State in notifying the Escrow Agent of distribution amounts to be made to the State and to each Eligible City and Eligible County, other than the Responsible Entity, shall modify the instructions it gives the Escrow Agent to accurately reflect such deductions and credits as set forth in this Section 4.C.(2)(b).

(ii) If the Responsible Entity is a City or County, in the manner set forth in the mathematical example attached hereto as Appendix M, to wit:

(aa) The entire MOU Proportional Allocable Share of the Responsible Entity shall be credited 50% to the State share and 50% to the Cities'/Counties' share until the Claim Over Offset Amount has been repaid in full, including interest as described in Section 4.C.(1)(b) of this Agreement. The Responsible Entity's MOU Proportional Allocable Share of any amounts redistributed to the Cities'/Counties' share under this paragraph (aa) shall be

credited 50% to the State and 50% pro rata to the remaining Cities and Counties (excluding the Responsible Entity) based on their MOU Proportional Allocable Shares.

(bb) At such time as any remaining Claim Over Offset Amount, including any interest as described in Section 4.C.(1)(b), is less than the Responsible Entity's MOU Proportional Allocable Share during any payment period then Section 4.C.(2)(a) shall govern distribution and allocation.

(cc) The State in notifying the Escrow Agent of distribution amounts to be made to the State and to each Eligible City and Eligible County, other than the Responsible Entity, shall modify the instructions it gives to the Escrow Agent to accurately reflect such deductions and credits as set forth in this Section 4.C.(2)(b).

(3) If any member of the City/County Steering Committee or the entity the State has identified as the Responsible Entity do not agree that the State has identified the appropriate Claim Over Offset Amount or the correct Responsible Entity, the State, any member of the City/County Steering Committee, or the identified Responsible Entity may petition the J.C.C.P. 4041 Court for a ruling and if any such party does, the State shall instruct the Escrow Agent to establish a Disputed Claims Account to hold such disputed amounts pending subsequent notification by the State which directs the manner of disposition to be made of the disputed amount. If, in response to a petition in which the State is not a named party, the J.C.C.P. 4041 Court issues an order or judgment that directs the manner of disposition to be made of the disputed amount, the Responsible Entity or the City/County Steering Committee member that has filed the petition shall, upon entry of such order or judgment by the J.C.C.P. 4041 Court, immediately notify the State of such ruling by providing the State with a copy of the order or judgment. The State, within twenty four (24) hours of receipt or the next business day, which ever is later, of such order or judgment, shall instruct the Escrow Agent as to the manner of disposition to be made of the disputed amount. Any such decision of the J.C.C.P. 4041 Court is appealable; however, no such appeal shall delay distribution of the disputed amounts absent a court order to the contrary from the appropriate California court.

(4) The parties to this Agreement agree that the Escrow Agent shall be entitled to rely upon the State's identification of the Responsible Entity and the Claim Over Offset Amount in allocating and distributing funds.

D. In the event of a conflict between the mathematical examples contained in Appendices J through M and the words contained in Sections 4.C.(1) through 4.C.(3) of this Agreement, the procedures set forth in the mathematical examples contained in Appendices J through M shall govern over words contained in Sections 4.C.(1) through 4.C.(3) of this Agreement.

E. In the event the Escrow Agent is required to establish a Disputed Claims Account pursuant to instructions given by the State pursuant to any provision of this Agreement, the State shall instruct the Escrow Agent that such account shall be established in the name of the Responsible Entity (i.e., "Disputed Claims Account of ---------) and that the Escrow Agent may charge each such Responsible Entity its normal charges for establishing and maintaining each such Disputed Claims Account. Provided, however that the State shall further instruct the Escrow Agent that: (i) if the J.C.C.P. 4041 Court finds, in response to a petition filed by the Responsible Entity or a member of the City/County Steering Committee, that the State has identified an amount which exceeds the appropriate Claim Over Offset Amount and/or that the State has not identified the correct Responsible Entity, the State shall be responsible for payment of the Escrow Agent's charges for establishing and maintaining the specific Disputed Claims Account in question; or (ii) if the J.C.C.P. 4041 Court finds, in response to a petition filed by the Responsible Entity or a member of the City/County Steering Committee, that the State has correctly identified the appropriate Claim Over Offset Amount and that the State has identified the correct Responsible Entity, those members of the City/County Steering Committee that filed the petition shall be responsible for payment of the Escrow Agent's charges for establishing and maintaining the specific Disputed Claims Account in question, and if the Responsible Entity filed the petition, the Responsible Entity shall be responsible for payment of the Escrow Agent's charges for establishing and maintaining the specific Disputed Claims Account in question. The Escrow Agent may, upon notice received from the State as to who is liable for the Escrow Agent's charges, deduct its charges from the amount due the State, the Responsible Entity, or those members of the City/County Steering Committee that filed the petition at the next distribution.

F. In the event of a conflict between Section 3.J and Section 4.C of this Agreement, the provisions of Section 4.C shall govern over the provisions of Section 3.J.

G. On the first Business Day after disbursing any funds from the California Account, the Escrow Agent shall deliver to the State a written statement showing the amount disbursed to the State and the amount disbursed to each Eligible City/Eligible County and the date of such transfer. As soon as practical after receipt of such information from the Escrow Agent, but in no event more than 24 hours after receipt of such information, or the next business day after receipt of such information, which ever is later, the State shall give notice to each City Designee and County Designee of which the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the information the State has received from the Escrow Agent.

H. Any dispute(s) between the State and/or any California City and/or California County regarding this Agreement or the MOU, including any dispute as to the appropriate Claim Over Offset Amount, or the identity of the correct Responsible Entity, shall be submitted to, and shall continue to be under, the jurisdiction of the J.C.C.P. 4041 Court, as set forth in Section 2 of this Agreement.

SECTION 5.
ATTORNEYS' FEES.

As provided under the MOU, Private Outside Counsel for the Represented Cities and Counties will make their best efforts to obtain their fees and costs from the Original Participating Manufacturers as provided for in the MSA. Any attorneys' fees and costs obtained shall be credited against the amounts owed to Private Outside Counsel under their contingency fee agreements. To the extent, if any, that an arbitration award is insufficient to satisfy the outstanding contingency fee contracts, and to the extent, if any, private counsel seek to enforce such contracts, all Cities and Counties receiving "MOU Proportional Allocable Share" will share the risk that attorneys' fees and costs may be due and owing to Private Outside Counsel who prosecuted the tobacco actions on behalf of the Represented Cities and Represented Counties. By executing this Agreement, each City and County covenants and agrees that: (1) to the extent that any of the Represented Cities and Counties pay attorneys' fees to their Private Outside Counsel, in any year, to compensate Private Outside Counsel for work done in the Represented Cities' and Counties' suits against the Participating Manufacturers, the "MOU Proportional Allocable Share" to be paid to the Eligible Cities and Eligible Counties in that year (or as soon thereafter as possible) will be decreased by an offset equal to the "Proportional Share Percentage" of the sum of fees and costs paid by any Represented City or Represented County; (2) The amount of the offset shall be added to the settlement proceeds to be paid to the Represented City or County that made the private counsel fee payment, provided however, that no Represented City or County shall be subject to an offset for attorneys' fees or costs paid by any other Represented City or County to Private Outside Counsel. For the purpose of this paragraph, "Proportional Share Percentage" shall mean the allocation percentage of the total amount payable to California local governments (as determined by the allocation formula set forth in paragraph 3.J of Section 6 of the MOU calculated as of the year of the fee payment in question), multiplied by the amount of the fee payment made by the Represented City or County in question; (3) A separate offset will be calculated for and paid to each Represented City and County that makes a fee payment to private counsel in any given year; and (4) In the event that any Represented City or Represented County makes any payment under such contingency fee contracts, such Represented City and/or Represented County shall notify the State of the amount of such attorney fee payment. The State shall thereafter instruct the Escrow Agent to make all appropriate offsets and credits pursuant to this section.

SECTION 6.
FAILURE OF ESCROW AGENT TO RECEIVE INSTRUCTIONS.

The parties to this Agreement agree that in the event that the Escrow Agent fails to receive any written instructions contemplated by this Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any Section of this Agreement.

SECTION 7.
INVESTMENT OF CALIFORNIA ACCOUNT FUNDS BY THE ESCROW AGENT.

A. Notwithstanding the more permissive investments permitted in the National Escrow Agreement, the State shall instruct the Escrow Agent to invest and reinvest all amounts in the California Account in only the following:

(1) Direct obligations of, or obligations the timely payment of principal and interest on which are fully and unconditionally guaranteed by, the United States of America or any agency thereof, maturing no more than one year after the date of acquisition thereof;

(2) Repurchase agreements fully collateralized by securities described in clause (1) above and with a counter party whose long-term debt securities are rated "AA" or higher by Standard & Poor's and "Aa" or higher by Moody's;

(3) Interest-bearing time or demand deposits with, or certificates of deposit maturing within 30 days of the acquisition thereof and issued by, any bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof and having combined capital, surplus and undistributed profits in excess of $500,000,000 whose long-term unsecured debt is rated "AA" or higher by Standard & Poor's and "Aa" or higher by Moody's;

(4) Commercial paper rated (on the date of acquisition thereof) at least A-1 and P-1 or equivalent by Standard & Poor's and Moody's, respectively, maturing not more than 180 days from the date of creation thereof; and

(5) Other investments specified by written instructions from all of the Original Participating Manufacturers, Settling States having Allocable Shares aggregating at least 66 ⅔%, and the State.

B. Each reference herein to a rating from Standard & Poor's or Moody's shall be construed as an equivalent rating by another nationally recognized credit rating agency of similar standing if neither of such corporations is then in the business of rating debt, and if one (but not both) of Standard & Poor's and Moody's is not then in the business of rating debt, the rating from the corporation still in such business shall suffice for purposes of this Section 7.

C. The State shall further instruct the Escrow Agent that to the extent practicable, monies credited to the California Account shall be invested in such a manner so as to be available for use at the times specified in writing by the Independent Auditor as the times when monies are expected to be disbursed by the Escrow Agent and charged to such California Account. Obligations purchased as an investment of monies credited to the California Account shall be deemed at all times to be a part of such California 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 equally between the State and the Eligible Cities and Eligible Counties), shall be credited or charged to the California Account and shall be for the benefit of, or be borne by, each governmental entity entitled to payment from such California Account.

D. In choosing among the investment options for the California Account described in subclauses (1) through (5) of this Section 7.A, the Escrow Agent shall comply with any instructions received from time to time from (i) the State and/or (ii) the State Investment Manager designated by the State pursuant to Section 10 of the Investment Management Agreement attached to the National Escrow Agreement. In the event of a conflict, instructions given pursuant to clause (i) of the preceding sentence shall govern over instructions given pursuant to clause (ii) of the preceding sentence. In the event of conflict, the Escrow Agent may seek confirmation from the designated State representative using established industry practices such as confirmation by phone or by facsimile or other electronic transmission. In the absence of such instructions or in the event of unresolved conflicting instructions, the Escrow Agent shall invest in accordance with subclause (1) of this Section 7.A.

E. The parties to this Agreement agree that the Escrow Agent shall have the right to liquidate any investments held hereunder in order to provide the funds necessary to make required payments from the California Account under this Agreement. The State shall instruct the Escrow Agent that to the extent practicable the Escrow Agent shall equally distribute the liquidation between the State and the Eligible Cities/Eligible Counties. The Escrow Agent hereunder shall not have any liability for any loss sustained as a result of any investment made pursuant to instructions received hereunder or as a result of any liquidation of any investment prior to its maturity in order to make a payment required under this Agreement.

F. The parties to this Agreement agree that the first Business Day after a liquidation has taken place, the Escrow Agent shall provide notice to the State of the amounts of the liquidation, the source of the liquidated securities, the current mark-to-market worth of the California Account, and the book value of the California Account. As soon as practical after receipt of such information from the Escrow Agent, but in no event more than 24 hours after receipt of such information, or the next business day after receipt of such information, which ever is later, the State shall give notice to each City Designee and County Designee of whom the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the information the State has received from the Escrow Agent.

SECTION 8.
SUBSTITUTE FORM W-9; QUALIFIED SETTLEMENT FUND.

Pursuant to the National Escrow Agreement, the State and each Eligible City and each Eligible County shall provide, if it has not already done so, 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 of this Agreement (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). A copy of the Form-W-9 is attached hereto as Appendix G. The Escrow established pursuant to the National Escrow Agreement and pursuant to this 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 made known to it by any Escrow Party or the Independent Auditor, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 9.
DUTIES AND LIABILITIES OF ESCROW AGENT.

A. The parties to this Agreement agree that 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 the National 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 State, or the State and any California local government units (whether or not the Escrow Agent has knowledge thereof) other than under the National Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in the National Escrow Agreement.

B. The parties to this Agreement agree that the Escrow Agent may rely and shall be protected in acting or refraining from acting upon any written notice or instruction furnished to it hereunder appearing on its face to have been sent by a person entitled hereunder to deliver such notice and reasonably believed by the Escrow Agent to be genuine and to have been signed or presented by the proper party or parties. The Escrow Agent shall be under no duty to inquire into or investigate the validity, accuracy or content of any such document. In the administration of the Escrow, the Escrow Agent may execute any of its powers and perform its duties hereunder directly or through agents or attorneys and may consult with counsel, accountants and other professional persons to be selected and retained by it.

C. The parties to this Agreement agree that in the event that the Escrow Agent shall be uncertain as to its duties or rights, or shall receive instructions, claims or demands which, in its reasonable opinion, conflict with any instructions it has received from the State, the Escrow Agent shall be entitled to refrain from taking any action other than investment and reinvestment in accordance with Section 7 and its sole obligation shall be to keep safe and invest in accordance with Section 7 all property held in escrow until it shall be directed otherwise in writing by the State.

SECTION 10.
NOTICES.

All notices or other communications to the State or to any City/County or to the City/County Steering Committee shall be given in writing (including, but not limited to, facsimile or other electronic transmission, telex, telecopy or similar writing). Notices or other communication provided by the State to individual Cities and individual Counties, or by individual Cities or Counties or by the City/County Steering Committee to the State via facsimile or other electronic transmission shall also be given via mail to the individual City Designees and County Designees or to the State at the address(es) to be provided to the State by the City Designees and County Designees or by the State to the City Designees and County Designees.

SECTION 11.
INTENDED BENEFICIARIES; SUCCESSORS.

No persons or entities other than the State and the Cities and Counties are intended beneficiaries of this Agreement, and only the State and the Cities and Counties shall be entitled to enforce the terms of this Agreement. The provisions of this Agreement shall be binding upon and inure to the benefit of the State and the Cities and Counties and their successors.

SECTION 12.
GOVERNING LAW.

After such time as all events and conditions set forth in Section 3.C of the National Escrow Agreement have been satisfied and the funds are released to the State (and by virtue of the MOU to the Cities and Counties), this Agreement shall be construed in accordance with and governed by the laws of California, without regard to the conflicts of law rules of California.

SECTION 13.
AMENDMENTS.

This Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment, including any affected City or County and the State. 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 to this Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 14.
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 or other electronic transmission of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, one executed original Agreement must promptly thereafter be delivered to the State and another executed original must promptly thereafter be delivered to the Escrow Agent.

SECTION 15.
CAPTIONS.

The captions herein are included only for convenience of reference and shall be ignored in the construction and interpretation hereof.

SECTION 16.
CONDITIONS TO EFFECTIVENESS.

This Agreement shall become effective when the State and no fewer than four members of the City/County Steering Committee shall have signed a counterpart hereof and the J.C.C.P. 4041 Court has entered an order approving, and retaining continuing jurisdiction over this Agreement.

SECTION 17.
ADDRESS FOR PAYMENT.

The State, in conformance with the requirements of this Agreement, shall provide the Escrow Agent with written disbursement instructions, which shall include the address to which payment shall be sent to each Eligible City and Eligible County, so that when funds in the California Account are required to be disbursed pursuant to this Agreement, the Escrow Agent will be able to disburse such funds.

SECTION 18.
REPORTING.

The State shall instruct the Escrow Agent to submit a monthly report to the State detailing at minimum: all deposits, transfers, disbursements, and balances of the California Account, a mark-to-market valuation of the California Account, the book value of the California Account, the fees and expenses owed to the Escrow Agent, the transactions executed by the Escrow Agent, and copies of any directions received by the State Investment Manager. As soon as practical after receipt of such information from the Escrow Agent, but in no event more than 48 hours after receipt of such information, or the next business day after receipt of such information, which ever is later, the State shall give notice to each City Designee and County Designee of whom the State is aware, by sending by facsimile or other electronic transmission to each such City Designee and County Designee, a copy of the information the State has received from the Escrow Agent.

IN WITNESS WHEREOF, the parties have executed this Agreement as of

_____, 2000.

[Signature Pages Follow.]

ESCROW AGREEMENT

This Escrow Agreement is entered into as of December 23, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and Citibank, N.A. 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 Citibank, N.A. 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") in accordance with written instructions from the Independent Auditor:

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"). The Escrow Agent shall be entitled to rely upon the Independent Auditor's identification of the Settling States and the Subsequent Participating Manufacturers that contributed to any amounts in an Account. 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 each date identified to the Escrow Agent by the Independent Auditor in writing as a date upon which any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

(a) 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 timely payment of principal and interest on which are fully and unconditionally guaranteed by, the United States of America or any agency thereof, maturing no more than one year after the date of acquisition thereof; (ii) repurchase agreements fully collateralized by securities described in clause (i) above and with a counterparty whose long-term debt securities are rated "AA" or higher by Standard & Poor's and "Aa" or higher by Moody's; (iii) interest-bearing time or demand deposits with, or certificates of deposit maturing within 30 days of the acquisition thereof and issued by, any bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof and having combined capital, surplus and undistributed profits in excess of $500,000,000 whose long-term unsecured debt is rated "AA" or higher by Standard & Poor's and "Aa" or higher by Moody's; (iv) commercial paper rated (on the date of acquisition thereof) at least A-1 and P-1 or equivalent by Standard & Poor's and Moody's, respectively, maturing not more than 180 days from the date of creation thereof; (v) money market funds that invest solely in securities described in clause (i) above, so long as (x) such funds are rated Aaa by Moody's and AAAm by Standard & Poor's, (y) investment therein is on a short-term basis pending disbursement or further investment and (z) absent extraordinary circumstances no more than 5% of the Escrow is held in such funds; and (vi) other investments specified by written instructions from all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%.

(b) Each reference herein to a rating from Standard & Poor's or Moody's shall be construed as an equivalent rating by another nationally recognized credit rating agency of similar standing if neither of such corporations is then in the business of rating debt and if one (but not both) of Standard & Poor's and Moody's is not then in the business of rating debt the required rating from the corporation still in such business shall suffice for purposes of this Section 5.

(c) 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 specified by the Independent Auditor in writing as 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.

(d) In choosing among the investment options described in subclauses (i) through (vi) of clause (a) of this Section 5 with respect to amounts credited to all Accounts that are not State-Specific Accounts, the Escrow Agent shall comply with any instructions received from time to time from (x) all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3% or (y) the Investment Manager specified in the Investment Management Agreement attached hereto as Appendix B (the "Investment Management Agreement") or any other investment manager designated by all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3% (the "Investment Manager"). In the event of a conflict, instruction given pursuant to clause (x) of the preceding sentence shall govern over instructions given pursuant to clause (y) of the preceding sentence. In the absence of such instructions, the Escrow Agent shall invest in accordance with subclause (i) of clause (a) of this Section 5.

(e) In choosing among the investment options described in subclauses (i) through (vi) of clause (a) of this Section 5 with respect to amounts credited to a State-Specific Account, the Escrow Agent shall comply with any instructions received from time to time from (x) the Settling State to which such State-Specific Account pertains or (y) the Investment Manager or any other investment manager designated by such Settling State pursuant to Section 10 of the Investment Management Agreement. In the event of a conflict, instruction given pursuant to clause (x) of the preceding sentence shall govern over instructions given pursuant to clause (y) of the preceding sentence. In the absence of such instructions, the Escrow Agent shall invest in accordance with subclause (i) of clause (a) of this Section 5.

(f) The Escrow Agent shall have the right to liquidate any investments held hereunder in order to provide funds necessary to make required payments from the appropriate Accounts under this Escrow Agreement. The Escrow Agent hereunder shall not have any liability for any loss sustained as a result of any investment made pursuant to the instructions of the parties hereto or as a result of any liquidation of any investment prior to its maturity in order to make a payment required under this Escrow Agreement.

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 made known to it by any Escrow Party or the Independent Auditor, 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.*

(a) 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.

(b) The Escrow Agent may rely and shall be protected in acting or refraining from acting upon any written notice or instruction furnished to it hereunder appearing on its face to have been sent by a person entitled hereunder to deliver such notice and reasonably believed by the Escrow Agent to be genuine and to have been signed or presented by the proper party or parties. The Escrow Agent shall be under no duty to inquire into or investigate the validity, accuracy or content of any such document. In the administration of the Escrow, the Escrow Agent may execute any of its powers and perform its duties hereunder directly or through agents or attorneys and may consult with counsel, accountants and other professional persons to be selected and retained by it. In the event that the Escrow Agent shall be uncertain as to its duties or rights hereunder or shall receive instructions, claims or demands from any party hereto which, in its reasonable opinion, conflict with any of the provisions of this Escrow Agreement, it shall be entitled to refrain from taking any action other than investment and reinvestment in accordance with Section 5 and its sole obligation shall be to keep safely and invest in accordance with Section 5 all property held in escrow until it shall be directed otherwise in writing by all of the Escrow Parties or by a final order or judgment of a court of competent jurisdiction.

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. Anything in this Escrow Agreement to the contrary notwithstanding, in no event shall the Escrow Agent be liable

for special, indirect or consequential loss or damage of any kind whatsoever (including but not limited to lost profits).

SECTION 9. *Resignation or Removal of Escrow Agent.*

The Escrow Agent may resign at any time by giving not less than ten Business Days' prior written notice thereof to the other Notice Parties and may be terminated at any time by not less than ten Business Days' prior written notice to the Escrow Agent from all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%, but such resignation or termination shall not become effective until a successor Escrow Agent, selected by all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%, 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 or termination, the resigning or terminated 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; Investment Manager Fees.*

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. The fees of the Investment Manager shall be paid in accordance with Section 10 of the Investment Management Agreement.

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 or by 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.*

(a) 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.

(b) Neither this Escrow Agreement nor any right or interest hereunder may be assigned in whole or in part by the Escrow Agent without the prior consent of all of the Escrow Parties.

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 Escrow 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 and the Escrow Court has entered an order approving, and retaining continuing jurisdiction over, the Escrow Agreement.

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.

SECTION 22. *Call-back Procedure.*

The Escrow Agent is authorized to seek confirmation of any written instructions received by it by telephone call-back to the person or persons at the sender of such instructions who is designated pursuant to subsection XVIII(k) of the Agreement to receive notice, and the Escrow Agent may rely upon the confirmation of anyone purporting to be the person or persons so designated. The persons and telephone numbers for call-backs may be changed only in a writing actually received and acknowledged by

the Escrow Agent. The parties to this Escrow Agreement acknowledge that such security procedure is commercially reasonable.

SECTION 23. *Investment Management Agreement.*

The Investment Management Agreement attached hereto as Appendix B is hereby incorporated by reference and execution of this Escrow Agreement by any Escrow Party shall constitute its execution of such Investment Management Agreement.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

APPENDIX A
(to Escrow Agreement)

FEE SCHEDULE FOR ESCROW SERVICES

First 12 months	$250,000
Second 12 months	$350,000
Each 12 months thereafter	$100,000

PHILIP MORRIS INCORPORATED

By: Martin J. Barrington

Martin J. Barrington
General Counsel

Date: December 23, 1998

BROWN & WILLIAMSON TOBACCO CORPORATION

By: _____

F. Anthony Burke
Vice President and General Counsel

Date: 12/23/98

LORILLARD TOBACCO COMPANY

By: Ronald S. Milstein for

Ronald S. Milstein
General Counsel

Date: 12/23/98

R.J. REYNOLDS TOBACCO COMPANY

By: Charles A. Blixt

Charles A. Blixt
Executive Vice President and
General Counsel

Date: 12-23-98

CITIBANK, N.A.

By: _____
Lida J. Price
Vice President

Date: 12/28/98

Bill Pryor
Attorney General of Alabama

Bruce M. Botelho
Attorney General of Alaska

Toetagata Albert Mailo
Attorney General of American Samoa

Grant Woods
Attorney General of Arizona

Winston Bryant
Attorney General of Arkansas

Daniel E. Lungren
Attorney General of California

Gale A. Norton
Attorney General of Colorado

Richard Blumenthal
Attorney General of Connecticut

M. Jane Brady
Attorney General of Delaware

John M. Ferren
Corporation Counsel of D.C.

Thurbert E. Baker
Attorney General of Georgia

By:
Michael C. Stern
Acting Attorney General of Guam

Margery S. Bronster
Attorney General of Hawaii

Alan G. Lance
Attorney General of Idaho

Jim Ryan
Attorney General of Illinois

Jeffrey A. Modisett
Attorney General of Indiana

Tom Miller
Attorney General of Iowa

Carla J. Stovall
Attorney General of Kansas

A.B. "Ben" Chandler III
Attorney General of Kentucky

Richard P. Ieyoub
Attorney General of Louisiana

Andrew Ketterer
Attorney General of Maine

J. Joseph Curran, Jr.
Attorney General of Maryland

Scott Harshbarger
Attorney General of Massachusetts

Frank J. Kelley
Attorney General of Michigan

Jeremiah W. Nixon
Attorney General of Missouri

Joseph P. Mazurek
Attorney General of Montana

Don Stenberg
Attorney General of Nebraska

Frankie Sue Del Papa
Attorney General of Nevada

Philip T. McLaughlin
Attorney General of New Hampshire

Peter Verniero
Attorney General of New Jersey

Tom Udall
Attorney General of New Mexico

Dennis C. Vacco
Attorney General of New York

Michael F. Easley
Attorney General of North Carolina

Heidi Heitkamp
Attorney General of North Dakota

Maya B. Kara
Acting Attorney General of N.
Mariana Island

Betty D. Montgomery
Attorney General of Ohio

W. A. Drew Edmondson
Attorney General of Oklahoma

Hardy Myers
Attorney General of Oregon

D. Michael Fisher
Attorney General of Pennsylvania

José A. Fuentes-Agostini
Attorney General of Puerto Rico

Jeffrey B. Pine
Attorney General of Rhode Island

Charlie Condon
Attorney General of South Carolina

Mark Barnett
Attorney General of South Dakota

John Knox Walkup
Attorney General of Tennessee

Jan Graham
Attorney General of Utah

William H. Sorrell
Attorney General of Vermont

Julio A. Brady
Attorney General of Virgin Islands

Mark L. Earley
Attorney General of Virginia

Christine O. Gregoire
Attorney General of Washington

Darrell V. McGraw Jr.
Attorney General of West Virginia

James E. Doyle
Attorney General of Wisconsin

Gay Woodhouse
Attorney General of Wyoming

COMMONWEALTH of VIRGINIA

Office of the Attorney General
Richmond 23219

Mark L. Earley
Attorney General

900 East Main Street
Richmond, Virginia 23219
804 • 786 • 2071
804 • 371 • 8946 TDD

December 22, 1998

By Telefax: (202) 408-6999

Ms. Karen Cordry
National Association of Attorneys General
750 1st Street, N.E., Suite 1100
Washington, D.C. 20002

Re: Tobacco Settlement - Draft Escrow Agreement and Investment Management Agreement

Dear Karen:

Pursuant to Laurie Loveland's December 20 letter (received December 21) forwarding copies of the draft Escrow Agreement and Investment Management Agreement, I have reviewed those agreements with our staff attorneys and enclose herewith the executed Authorization Form for electronic signature.

Because the Investment Management Agreement (Appendix B to the Escrow Agreement) was not previously an exhibit to the Master Settlement Agreement, I must note one potential problem that arises under Virginia law. To the extent that any provisions of the Investment Management Agreement (including, but not limited to, paragraphs 12 and 16) are found to constitute indemnification or hold-harmless agreements that waive the sovereign immunity of the Commonwealth of Virginia, they would be void and unenforceable as a matter of Virginia law. Only the General Assembly of Virginia can waive the Commonwealth's sovereign immunity.

I appreciate your and Laurie Loveland's taking the time to explain certain provisions of these agreements to my staff attorneys and your continued assistance in this complex transaction.

In accordance with the instructions in the December 20 letter, the Attorney General has also executed the original signature block, and we are mailing that to you with the original of this letter.

Sincerely,

Randolph A. Beales

Randolph A. Beales
Chief Deputy Attorney General

2:6/263

cc: The Honorable Mark L. Earley, Attorney General
Ms. Laurie J. Loveland, NAAG
Ms. Judith Williams Jagdmann, Deputy Attorney General
Enclosures

jas/NAAG Letter1

APPENDIX B
(to Escrow Agreement)

INVESTMENT MANAGEMENT AGREEMENT

This is an Investment Management Agreement (including Annexes I and II hereto, this "Agreement") made by and between Salomon Smith Barney Inc. (herein referred to as the "Manager") and the Escrow Parties (herein collectively referred to as the "Client") identified in an Escrow Agreement dated as of December 23, 1998 (the "Escrow Agreement"), to which this Agreement is an appendix. Capitalized terms used herein and not otherwise defined shall have the meanings ascribed thereto in the Escrow Agreement.

1. The Manager will supervise and manage the investment of the Escrow established pursuant to the Escrow Agreement subject to the terms of the Escrow Agreement and to such limitations as the Client may impress upon Manager pursuant to paragraph 5 below. The Escrow Agent shall be the custodian to maintain possession of the Escrow and the Escrow Agent will not charge any custody fees over and above the Escrow Agent's fees for escrow services.

2. The Client hereby authorizes the Manager, at any time and from time-to-time, in connection with the performance of Manager's services hereunder, to issue instructions to any custodian of the Escrow or to any broker selected by the Manager for the sale, purchase or exchange of any securities or investments which the Manager may deem advisable in connection with the management of the Escrow. It is understood that brokers will be selected in accordance with the practices and procedures set forth in the Manager's response to item 12 of Part II of the Manager's Form ADV, as amended from time to time.

3. It is explicitly understood that any information or recommendations supplied by the Manager in connection with the performance of the Manager's obligations hereunder are to be regarded as confidential and for use only by the Client or such persons as the Client may designate in connection with the Escrow.

4. Nothing herein contained shall be construed to prevent the Manager or any of the Manager's affiliates and/or employees in any way from purchasing or selling any securities for the Manager's or its affiliates' and/or employees' own account(s) or for the account(s) of any other client, provided, however, that no such transaction shall violate any applicable law.

5. The Client hereby authorizes the Manager to manage the Escrow in accordance with Section 5 of the Escrow Agreement and the investment objectives and restrictions attached as Annex I hereto. With respect to any amounts credited to a State-Specific Account, the Investment Manager 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 Section 5 of the Escrow Agreement and is made known to it in writing by such Settling State. The Client may change these investment objectives and restrictions at any time and from time to time by a notice to the Manager signed by either (x) all of the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%, with respect to Accounts other than State-Specific Accounts governed by a separate Investment Management Agreement entered into pursuant to Section 7 of this Agreement, or (y) the Settling State to which such Account pertains, with respect to a State-Specific Account that is governed by a separate Investment Management Agreement entered into pursuant to Section 7 of this Agreement. Such changes will be confirmed to the Client by the Manager in writing. The Manager will not be required to sell any securities that become impermissible investments as a result of such change unless the Client specifically directs the Manager to do so in a notice signed by the parties specified in clause (x) or (y) (as applicable) of the preceding sentence. The Manager will, however, use its reasonable efforts to notify the Client promptly when the Manager becomes aware of a downgrade which, had it been in effect at the time of purchase of the instrument, would have meant that the instrument would not have been a permissible investment under clause (a) of Section 5 of the Escrow Agreement and the Manager will promptly effect the disposition of the instrument following notice to the Client unless (a) otherwise instructed by a notice signed by the parties specified in clause (x) or (y) (as applicable) of the second preceding sentence, or (b) the Manager believes it is not in the best interest of Client to dispose of the instrument at such time.

6. The Manager will seek to achieve the investment objectives of the Escrow, but except for negligence or willful misconduct, neither the Manager nor any of the Manager's partners, officers, directors or employees shall be liable hereunder for any action performed or omitted to be performed, or for any errors of judgment in managing the investment of the assets of the Escrow. Nothing in this Agreement shall constitute a waiver or limitation of any right that the Client may have under the federal securities laws or any rules thereunder. The Manager will indemnify and hold harmless the Client from and against all loss, claims, liabilities and damages (including without limitation reasonable attorney's fees, but excluding any indirect, special or consequential damages), arising out of or resulting from the negligence or willful misconduct of the Manager and the Manager's partners, officers, directors and employees in connection with any action or failure to act relating to the Escrow.

7. The obligations of the parties under this Agreement shall commence when (a) this Agreement is signed by the Manager and (b) the Escrow Agreement is signed by all of the Settling States and Original Participating Manufacturers, and shall continue until canceled upon 10 days written notice as follows: Manager may terminate this Agreement upon not less than 10 days' written notice to client and each other Notice Party. Client may terminate this Agreement by delivery of written notice to Manager and each other Notice Party at least 10 days prior to the effective date of such termination or at any time prior to the Escrow Agreement becoming effective pursuant to Section 19 thereof (a) with respect to all Accounts that are not State-Specific Accounts, from all of the Original

Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%, and (b) with respect to a State Specific Account, from the Settling State to which such State-Specific Account pertains. Any notice of termination of Manager delivered pursuant to clause (b) of the preceding sentence shall designate a successor Manager, which shall be either The Chase Manhattan Bank or Bank of America, and the copy of such notice delivered to Notice Parties other than Settling States shall be accompanied by an executed investment management agreement between such Settling State, as Client, and such successor Manager in substantially the form of this Agreement. Manager shall cooperate in effecting a transition to any successor Manager. The Client may also terminate this Agreement without any penalty within five business days after the initial agreement date indicated below. The fees for the Manager's services set forth below shall accrue and be payable through the effective date of cancellation.

8. The Manager represents to the Client that the Manager is registered as an investment adviser under the Investment Advisers Act of 1940.

9. This Agreement shall not be assignable by the Manager without the consent of the Client. This Agreement represents the entire agreement between the parties with respect to the services described herein. Except as otherwise provided herein with respect to modifications that may be effected by notice from the Original Participating Manufacturers and Settling States having Allocable Shares aggregating at least 66-2/3%, this Agreement may be modified or amended only by written instrument executed by all of the parties hereto that would be affected by the modification or 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 Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party. This Agreement supersedes all previous agreements and understandings between the parties hereto with respect to the subject matter hereof.

10. The fees for the Manager's services hereunder are to be in accordance with the fee schedule attached as Annex II hereto, and the Independent Auditor is hereby authorized by the Client to direct the Escrow Agent to charge the Accounts for which Manager acts as Manager quarterly in arrears on the first business day of the following month with the amount of said fees. The fee schedule may be amended from time-to-time by mutual written agreement of the Manager and (x) all of the Original Participating Manufacturer and Settling States having Allocable Shares aggregating at least 66-2/3%, in the case of Accounts other than State-Specific Accounts governed by a separate Investment Management Agreement entered into pursuant to Section 7 of this Agreement, or (y) the Settling State to which such Account pertains, with respect to a State-Specific Account that is governed by a separate Investment Management Agreement entered into pursuant to Section 7 of this Agreement. Fees are computed on the average daily assets in the Escrow.

11. The Manager will notify the Client of any changes in the identity of the Manager's key investment personnel with responsibility for the services to be performed hereunder within a reasonable time after such change.

12. The authority of the Manager hereunder shall continue notwithstanding the Client's insolvency, bankruptcy or any legal disability and the Client agrees hereby to hold the Manager harmless (as and to the extent set forth in paragraph 16 hereof) from all liability, loss and expense arising as a consequence of any action taken or omitted to be taken by the Manager after any such event and prior to receipt of actual knowledge of such event. The Client hereby authorizes the Manager to accept and rely upon all instructions given on the Client's behalf by any person or entity the Manager reasonably believes to be the Client's authorized agent (agents) if such instructions are not inconsistent with the Escrow Agreement. All instructions will continue to be effective until canceled.

13. Any notices to be sent to the Client pursuant to this agreement shall be delivered to the Client in accordance with Section 11 of the Escrow Agreement, and any notices to be delivered to the Manager shall be addressed as follows:

Salomon Smith Barney Inc.
388 Greenwich Street
New York, New York 10013
Attn: John Hartigan, Managing Director
Michael Rosenbaum, General Counsel, Asset Management
Phone: (212) 816-6000
Fax: (212) 816-5338

14. The Client hereby agrees and acknowledges that the Manager may act on the Client's behalf even though the Manager or any of the Manager's affiliates may have a potential conflict of duty or interest in a transaction, provided that such conflict and the nature thereof is disclosed to the Client in Part II of Manager's Form ADV or otherwise in writing. This includes the fact that the Manager or one of the Manager's affiliates may: (a) provide brokerage services to other clients; (b) act as underwriter, dealer or placement agent with respect to securities; (c) invest on the Client's behalf in mutual or unit trust funds established, sponsored, advised or managed by the Manager or one of the Manager's affiliates; (d) act as a counterparty in currency exchange transactions; (e) act in the same transaction as agent for more than one client; or (f) have a material interest in an issue of securities. Manager earns fees and profits from the activities described in the previous sentence in addition to the fees charged to the Client for the Manager's services under this Agreement.

15. This Agreement and the legal relations between the parties shall be governed by and construed in accordance with the laws of the State of New York, without regard to conflict of law doctrines.

16. The Client shall, by allowance of a claim for set-off against the funds under management hereunder, indemnify, hold harmless and defend the Manager (ratably to the funds under management hereunder payable to it) 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 Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own negligence or willful misconduct. Anything in this Agreement to the contrary notwithstanding, in no event shall the Manager be liable for special, indirect or consequential loss or damage of any kind whatsoever (including but not limited to lost profits). The provisions of this Section 16 shall survive termination of this Agreement.

17. The Manager shall have the right to cause the liquidation of any investments held under the Escrow Agreement in order to provide funds necessary to make payments required under the Escrow Agreement. The Manager shall not have any liability for any loss sustained as a result of any liquidation of any investment prior to its maturity in order to make a payment required under the Escrow Agreement.

18. By acceptance of this Agreement, the Client acknowledges receipt of Part II of the Manager's Form ADV.

MANAGER:

By: Patrick Lucas

Title: Managing Director

Date: 12/23/98

ANNEX I TO APPENDIX B

INVESTMENT GUIDELINES

Investment Objectives:	To maximize current income to the extent consistent with the preservation of principal and the maintenance of liquidity.
Risk Tolerance:	Low
Time Horizon:	The weighted average duration of the total portfolio shall be consistent with the anticipated disbursement schedule under the Escrow Agreement.
Permitted Investments:	As provided in Section 5 of the Escrow Agreement.
Performance Benchmark:	To be agreed upon by Manager and Client.

ANNEX II TO APPENDIX B

FEE SCHEDULE FOR INVESTMENT MANAGEMENT SERVICES

1.5 basis points per annum, payable quarterly in arrears based on average deposit balance for preceding quarter.

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

Coordination Proceeding Special Title (Rule 1550(b))	No. JCCP 4041
TOBACCO CASES I	
Including Actions:	
Cordova vs. Liggett Group, Inc.	San Diego Superior Court No. 651824
Davis vs. R.J. Reynolds Tobacco Co.	San Diego Superior Court No. 706458
County of Los Angeles vs. R.J. Reynolds Tobacco Co.	San Diego Superior Court No. 707651
People vs. Philip Morris, Inc.	San Francisco Superior Court No. 980864
People vs. Philip Morris, Inc.	Sacramento Superior Court No. 97AS 03031

RELEASE AND DISCHARGE OF CLAIMS

(THIS PAGE INTENTIONALLY LEFT BLANK)

WHEREAS the City/County of _____ (hereinafter the "Undersigned City/County") wishes to receive its allocated share of settlement proceeds as provided for and set forth in the Memorandum of Understanding ("MOU"), a copy of which is attached as Exhibit B to the Consent Decree and Final Judgment agreed to by the State of California and various Participating Manufacturers of Tobacco Products in the matter of People of the State of California, et al. v. Philip Morris Inc., et al., Case No. J.C.C.P. 4041 (originally filed as Sacramento Superior Court Case No. 97 AS 03031), which Consent Decree and Final Judgment was entered by the Court on December 9, 1998 (a copy of which is attached as Exhibit B to the Agreement Regarding Interpretation of Memorandum of Understanding), and incorporates within it as exhibit A thereto the Master Settlement Agreement ("MSA") entered on November 23, 1998;

WHEREAS, the Attorney General of the State of California and representatives of a number of California Counties and Cities entered into the MOU dated August 5, 1998, which allocates a portion of settlement proceeds to certain California Cities and all California Counties that comply with the terms of the MOU, by releasing all Released Claims such City or County may have consistent with the extent of the State's Release, and dismissing any Released Claims from any pending actions with prejudice;

WHEREAS, the State of California and certain Participating Manufacturers of Tobacco Products entered into the MSA, the terms of which were approved by the Court by the entry of the Consent Decree and Final Judgment;

WHEREAS, certain Cities and Counties within the State of California had, prior to December 9, 1998, commenced litigation asserting various claims for monetary, equitable and

injunctive relief against certain Participating Manufacturers and others as defendants,[1] and other Cities or Counties that have not filed suit can potentially assert similar claims;

WHEREAS, the ability of each eligible City and County to share in its portion of the settlement proceeds is conditioned upon a release executed by the eligible City and County of tobacco related claims which is consistent with the extent of the State's release, and dismissal of any Released Claims from any pending actions with prejudice;

WHEREAS, the Undersigned City/County has obtained any necessary approval to participate in the settlement under the terms and conditions as memorialized in the MOU and the MSA executed between the Attorney General of the State of California and the Participating Manufacturers; and

WHEREAS, in consideration for receiving its portion of the settlement proceeds as allocated to Cities and Counties in the MOU, the Undersigned City/County executes this Release, consistent with the terms of the MOU and the MSA;

NOW THEREFORE THE PARTIES HEREBY AGREE AS FOLLOWS:

1. DEFINITIONS

As used herein, the following terms have the same meaning as and are defined the same as they are defined in the Master Settlement Agreement and the Agreement Regarding Interpretation of Memorandum of Understanding[2] unless specifically modified in this paragraph 1:

---

[1] People of the State of California, et al., v. Philip Morris Inc., et al., No. 980864 (San Francisco County Superior Court); The City and County of San Francisco, et al., v. Philip Morris Inc., et al., No. C-96-2090-DLJ (N.D. Cal.); and County of Los Angeles v. R.J. Reynolds Tobacco Co., et al., No. 707651 (San Diego Superior Court).

[2] For the purposes of this Release, the meaning of terms appearing herein with initial capitalized letters that are not specifically separately defined in this paragraph 1, have the same definition as such term has in the Master Settlement Agreement or the Agreement Regarding Interpretation of Memorandum of Understanding.

(a) The term "City/County" and variations thereon, as used herein means each individual City and/or County which signs this Release and includes all past, present and future agencies, districts, divisions and departments, as well as all past, present and future officers, directors, employees, agents and attorneys of such executing City and/or County.

(b) The term "Master Settlement Agreement" or "MSA" means that document, including exhibits thereto, which is attached as Exhibit A to the Consent Decree and Final Judgment entered by the San Diego Superior Court on December 9, 1998, in People of the State of California, ex rel Daniel E. Lungren, et al. v. Philip Morris Inc., et al., J.C.C.P. 4041 (originally filed as Sacramento Superior Court No. 97 AS 30301), and includes any subsequent agreements with respect to modifications of the MSA.

(c) The term "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 the Master Settlement Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(d) The term "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to the MSA, 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 the MSA 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 the MSA 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 the MSA after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing the MSA, 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 November 23, 1998. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in the MSA, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer.

(e) The term "Released Claims" means: (1) for conduct, acts or omissions occurring prior to November 23, 1998 (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 footnote 1 of this Release, 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 (whether or not the Undersigned City/County has brought such action)), except for claims 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 the MSA); (2) for conduct, acts or omissions occurring after November 23, 1998, 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.

(g) The term "Released Parties" means all Participating Manufacturers and their 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 of any Participating Manufacturer (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 November 23, 1998, unless such person or entity becomes a Participating Manufacturer.

(f) The term "Represented City," "Represented County" and/or "Represented Cities and Counties" means individually or collectively, the City and County of San Francisco, the Cities of Los Angeles, San Diego and San Jose, and the Counties of Alameda, Contra Costa, Marin, Monterey, Orange, Riverside, Sacramento, San Bernardino, San Diego, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Shasta and Ventura who executed contingency fee contracts with private outside counsel to prosecute tobacco- related claims, and the County of Los Angeles who executed a separate contingent fee contract with private outside counsel to prosecute tobacco-related claims.

2. Upon the occurrence of State-Specific Finality in California, and the entry of a dismissal with prejudice in People of the State of California, et al. v. Philip Morris Inc., et al., No. 980864 (San Francisco County Superior Court), City and County of San Francisco, et al. v. Philip Morris Inc., et al., No. C-96-2090-DLJ (N.D. Cal.) and County of Los Angeles, et al. v. R.J.

Reynolds Tobacco Co., et al., No. 707651 (San Diego County Superior Court), the Undersigned City/County shall absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Undersigned directly, indirectly, derivatively or in any other capacity ever had, now has, or hereafter can, shall or may have.

3. This Release and Discharge of Claims shall not apply to, and shall be of no force or effect as against, any Participating Manufacturer which is a signatory to the MSA or as to or against the Undersigned City/County if, for any reason whatsoever, State Specific Finality does not occur in California or the provisions of the MSA or the Consent Decree and Final Judgment entered in the matter of People of the State of California, et al. v. Philip Morris, Inc., et al., Case No. J.C.C.P. 4041 (originally filed as Sacramento Superior Court Case No. 97 AS 03031) are reversed.

4. The Undersigned City/County covenants and agrees that it shall not after the occurrence of State-Specific Finality in California 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.

5. The Undersigned City/County covenants and agrees that, if a Released Claim brought by the Undersigned City/County against any person or entity that is not a Released Party (a "non-Released Party"), or against any retailer, supplier or distributor who is a Released Party, but who is not released from a Released Claim because of the operation of paragraph 9 below (hereinafter a "non-Released Retailer"), results in or in any way gives rise to a claim-over (e.g., a cross-complaint; on any theory whatever other than a claim based on an express written indemnity agreement) by such non-Released Party or non-Released Retailer against any Released Party (and the Attorney General gives notice to the undersigned and to Milberg Weiss Bershad Hynes & Lerach LLP ("Milberg Weiss"), the City and County of San Francisco, Leiff Cabraser Heiman & Bernstein ("LCHB") and

Robinson, Calcagnie & Robinson ("Robinson") within 30 days of the service of such claim-over and prior to entry into any settlement of such claim-over), the Undersigned City/County:

(a) shall reduce or credit against any judgment or settlement it may obtain against such non-Released Party or non-Released Retailer the full amount of any judgment or settlement such non-Released Party or non-Released Retailer may obtain against the Released Party on such claim-over (e.g., if the amount obtained on the claim-over against the Released Party by the non-Released Party or non-Released Retailer is equal to the amount of the settlement or judgment the Undersigned City/County obtains against the non-Released Party or non-Released Retailer, the City/County shall receive no payment on its settlement or judgment since the full amount of such settlement or judgment shall be reduced by the amount obtained on the claim-over against the Released Party by the non-Released Party or non-Released Retailer); and

(b) shall, as part of any settlement with such non-Released Party or non-Released Retailer, obtain from such non-Released Party or non-Released Retailer for the benefit of such Released Party a satisfaction in full of such non-Released Party's or non-Released Retailer's judgment or settlement against the Released Party.

6. The Undersigned City/County further agrees that in the event that the provisions of paragraph 5 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 or non-Released Retailer to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement judgment or otherwise), of such non-Released Party or non-Released Retailer to the Undersigned City/County arising out of any Released Claim, (to the extent that the Attorney General

has given notice to the undersigned and to Milberg Weiss, the City and County of San Francisco, LCHB and Robinson within 30 days of the service of such claim-over and prior to entry into any settlement of such claim-over), 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 claim-over liability as against the payment the Original Participating Manufacturer is to make pursuant to the MSA (determined as described in step "E" of clause "Seventh" of §IX(j) of the MSA) up to the full amount of such Original Participating Manufacturer's share of the MSA Allocated Payment each year, until all such amounts paid on such claim-over liability have been offset. The Undersigned City's/County's MOU Proportional Allocable Share shall likewise be reduced dollar-for-dollar until the full claim-over amount of the Original Participating Manufacturer's offset has been deducted from the MOU Proportional Allocable Share owing to the Undersigned City/County. The amount deducted from the MOU share owing to the Undersigned City/County will be distributed, pursuant to the terms of the MOU, 50% to the State and 50% to the other cities and counties which did not bring the original action against the non-Released Party or non-Released Retailers which gave rise to the claim-over.

7. The Undersigned City/County does not purport to waive or release any claims on behalf of Indian tribes.

8. The Undersigned City/County does not waive or release any criminal liability based on federal, state or local law.

9. 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.

10. As provided under the MOU, Private Outside Counsel for the Represented Cities and Counties will make their best efforts to obtain their fees and costs from the Original Participating Manufacturers as provided for in the MSA. Any attorneys fees and costs obtained shall be credited against the amounts owed Private Outside Counsel under their contingency fee agreements. To the extent, if any, that the arbitration award is insufficient to satisfy the outstanding contingency fee contracts, and to the extent, if any, private counsel seek to enforce such contracts, all cities and counties receiving an allocated share of settlement proceeds pursuant to the MOU will share the risk that attorneys fees and costs may be due and owing to Private Outside Counsel who prosecuted the tobacco actions identified in footnote 1 herein. Accordingly, the Undersigned City/County, as well as every other non-litigating County covenants and agrees that, to the extent that any of the Represented Cities and Counties pay attorney's fees to their Private Outside Counsel, in any year, to compensate Private Outside Counsel for work done in the Cities' and Counties' suits against the Participating Manufacturers, the settlement proceeds to be paid to the Undersigned City/County in that year (or as soon thereafter as possible) will be decreased by an offset equal to the Undersigned City's/County's "Proportional Share Percentage" of the sum of fees and costs paid by any Represented City or County. The amount of the offset shall be added to the settlement proceeds to be paid to the Represented City or County that made the private counsel fee payment, provided however, that no Represented City or County shall be subject to an offset for attorneys' fees or costs paid by any other Represented City or County to Private Outside Counsel. For the purpose of this paragraph, "Proportional Share Percentage" shall mean the Undersigned City's/County's allocation percentage of the total amount payable to California local governments (as determined by the

allocation formula set forth in the MOU, calculated as of the year of the fee payment in question), multiplied by the amount of the fee payment made by the Represented City or County in question. A separate offset will be calculated for and paid to each Represented City and County that makes a fee payment to private counsel in any given year.

11. Except as otherwise stated herein, 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 herein release all Released Claims against the Released Parties, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, that the Undersigned City/County may have against the Released Parties, and the Undersigned City/County understands and acknowledges the significance and consequences of waiver of any such provision and hereby assumes full responsibility for any injuries, damages or losses that the Undersigned City/County may incur.

DATED: _____

CITY/COUNTY OF

_____

_____

BY:

Appendix E

MODEL RESOLUTION BY CITY COUNCIL

A RESOLUTION AUTHORIZING WITHDRAWAL AND ACCEPTANCE OF TOBACCO SETTLEMENT MONIES PURSUANT TO THE MEMORANDUM OF UNDERSTANDING

WHEREAS the Attorney General of the State of California and representatives of a number of California Counties and Cities entered into a Memorandum of Understanding ("MOU"), which allocates a portion of settlement proceeds stemming from litigation against various manufacturers of tobacco products;

WHEREAS the City of _____ (hereinafter "the City") wishes to receive its allocated share of settlement proceeds as provided for and set forth in the MOU;

WHEREAS the City has obtained any necessary approval to participate in the settlement under the terms and conditions memorialized in the MOU; and

WHEREAS the City has, in consideration for receiving its portion of the settlement proceeds as allocated to Cities and Counties in the MOU, executed the Agreement Regarding Interpretation of MOU and the Release, approved by the J.C.C.P. 4041Court;

NOW, THEREFORE, BE IT RESOLVED that the City Council does hereby authorize the acceptance and deposit of the City's portion of the settlement proceeds as allocated to Cities and Counties in the MOU.

BE IT FURTHER RESOLVED, that the City Council does hereby authorize the verification by the Office of the Attorney General of all banking information provided to effectuate the acceptance of the settlement proceeds.

///

///

BE IT FURTHER RESOLVED, that the following officers or their successors in office shall be authorized to direct the transfer of the City's settlement funds on behalf the City:

_____	_____	_____
(NAME)	(NAME)	(NAME)
_____	_____	_____
(TITLE)	(TITLE)	(TITLE)
_____	_____	_____
(SIGNATURE)	(SIGNATURE)	(SIGNATURE)

BE IT FURTHER RESOLVED, that all notices from the Office of the Attorney General to the City regarding tobacco settlement funds shall be sent to following person/agency:

Name of Person/Agency: _____

Title: _____

Address: _____

_____

_____

Telephone: _____

Facsimile: _____

E-Mail: _____

PASSED AND ADOPTED, by the City Council of the City of _____, County of _____, State of California, this ____ day of _____, ____.

Appendix E

MODEL RESOLUTION BY COUNTY BOARD OF SUPERVISORS

A RESOLUTION AUTHORIZING WITHDRAWAL AND ACCEPTANCE OF TOBACCO SETTLEMENT MONIES PURSUANT TO THE MEMORANDUM OF UNDERSTANDING

WHEREAS the Attorney General of the State of California and representatives of a number of California Counties and Cities entered into a Memorandum of Understanding ("MOU"), which allocates a portion of settlement proceeds stemming from the litigation against various manufacturers of tobacco products;

WHEREAS the County of _____ (hereinafter "the County") wishes to receive its allocated share of settlement proceeds as provided for and set forth in the MOU;

WHEREAS the County has obtained any necessary approval to participate in the settlement under the terms and conditions memorialized in the MOU; and

WHEREAS in consideration for receiving its portion of the settlement proceeds as allocated to Cities and Counties in the MOU, the County has executed the Agreement Regarding Interpretation of MOU and the Release, approved by the J.C.C.P. 4041Court;

NOW, THEREFORE, BE IT RESOLVED that the Board of Supervisors does hereby authorize the acceptance and deposit of the County's portion of the settlement proceeds as allocated to Cities and Counties in the MOU.

BE IT FURTHER RESOLVED, that the Board of Supervisors does hereby authorize the verification by the Office of the Attorney General of all banking information provided to effectuate the acceptance of the settlement proceeds.

///

///

BE IT FURTHER RESOLVED, that the following officers or their successors in office shall be authorized to direct the transfer of the County's settlement funds on behalf the County:

_____	_____	_____
(NAME)	(NAME)	(NAME)
_____	_____	_____
(TITLE)	(TITLE)	(TITLE)
_____	_____	_____
(SIGNATURE)	(SIGNATURE)	(SIGNATURE)

BE IT FURTHER RESOLVED, that all notices from the Office of the Attorney General to the County regarding tobacco settlement funds shall be sent to following person/agency:

Name of Person/Agency: _____

Title: _____

Address: _____

_____

_____

Telephone: _____

Facsimile: _____

E-Mail: _____

PASSED AND ADOPTED, by the Board of Supervisors of the County of _____, State of California, this ____ day of _____, ____.

Appendix F
Transfer Instructions

CALIFORNIA ACCOUNT - TOBACCO SETTLEMENT FUND
Wiring Instructions Information Form

Please complete this form and mail to the Office of the Attorney General, Tobacco Litigation Section, P.O. BOX 944255, Sacramento, CA 94244-2550

CITY/COUNTY NAME

_____

BANK ROUTING INFORMATION

Bank Name : _____

Bank ABA Routing #: _____

Bank Account #: _____

Bank Account Name: _____

Bank Address: _____

Bank Branch #: _____

Bank Telephone #: _____ Bank Fax #: _____

Bank Contact Person, Title, Telephone # and E-mail Address: _____

_____

AUTHORIZED SIGNATURES
(Signatures of two of three designated city/county officers are required)

_____ _____
Typed or Printed Name Typed or Printed Name

_____ _____
Signature Signature

Date: _____ Date: _____

Form **W-9**
(Rev. December 1996)
Department of the Treasury
Internal Revenue Service

Request for Taxpayer Identification Number and Certification

Give form to the requester. Do NOT send to the IRS.

Please print or type

Name (If a joint account or you changed your name, see **Specific Instructions** on page 2.)

Business name, if different from above. (See **Specific Instructions** on page 2.)

Check appropriate box: ☐ Individual/Sole proprietor ☐ Corporation ☐ Partnership ☐ Other ▶

Address (number, street, and apt. or suite no.)

Requester's name and address (optional)

City, state, and ZIP code

Part I Taxpayer Identification Number (TIN)

Enter your TIN in the appropriate box. For individuals, this is your social security number (SSN). However, if you are a resident alien OR a sole proprietor, see the instructions on page 2. For other entities, it is your employer identification number (EIN). If you do not have a number, see **How To Get a TIN** on page 2.

Note: *If the account is in more than one name, see the chart on page 2 for guidelines on whose number to enter.*

Social security number

OR

Employer identification number

List account number(s) here (optional)

Part II For Payees Exempt From Backup Withholding (See the instructions on page 2.)

▶

Part III Certification

Under penalties of perjury, I certify that:

1. The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me), **and**
2. I am not subject to backup withholding because: **(a)** I am exempt from backup withholding, or **(b)** I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of a failure to report all interest or dividends, or **(c)** the IRS has notified me that I am no longer subject to backup withholding.

Certification Instructions.—You must cross out item 2 above if you have been notified by the IRS that you are currently subject to backup withholding because you have failed to report all interest and dividends on your tax return. For real estate transactions, item 2 does not apply. For mortgage interest paid, acquisition or abandonment of secured property, cancellation of debt, contributions to an individual retirement arrangement (IRA), and generally, payments other than interest and dividends, you are not required to sign the Certification, but you must provide your correct TIN. (See the instructions on page 2.)

Sign Here Signature ▶ Date ▶

Purpose of Form.—A person who is required to file an information return with the IRS must get your correct taxpayer identification number (TIN) to report, for example, income paid to you, real estate transactions, mortgage interest you paid, acquisition or abandonment of secured property, cancellation of debt, or contributions you made to an IRA.

Use Form W-9 to give your correct TIN to the person requesting it (the requester) and, when applicable, to:

1. Certify the TIN you are giving is correct (or you are waiting for a number to be issued),
2. Certify you are not subject to backup withholding, or
3. Claim exemption from backup withholding if you are an exempt payee.

Note: *If a requester gives you a form other than a W-9 to request your TIN, you must use the requester's form if it is substantially similar to this Form W-9.*

What Is Backup Withholding?—Persons making certain payments to you must withhold and pay to the IRS 31% of such payments under certain conditions. This is called "backup withholding." Payments that may be subject to backup withholding include interest, dividends, broker and barter exchange transactions, rents, royalties, nonemployee pay, and certain payments from fishing boat operators. Real estate transactions are not subject to backup withholding.

If you give the requester your correct TIN, make the proper certifications, and report all your taxable interest and dividends on your tax return, payments you receive will not be subject to backup withholding. Payments you receive **will** be subject to backup withholding if:

1. You do not furnish your TIN to the requester, or
2. The IRS tells the requester that you furnished an incorrect TIN, or
3. The IRS tells you that you are subject to backup withholding because you did not report all your interest and dividends on your tax return (for reportable interest and dividends only), or
4. You do not certify to the requester that you are not subject to backup withholding under 3 above (for reportable interest and dividend accounts opened after 1983 only), or
5. You do not certify your TIN when required. See the Part III instructions on page 2 for details.

Certain payees and payments are exempt from backup withholding. See the Part II instructions and the separate **Instructions for the Requester of Form W-9.**

Penalties

Failure To Furnish TIN.—If you fail to furnish your correct TIN to a requester, you are subject to a penalty of $50 for each such failure unless your failure is due to reasonable cause and not to willful neglect.

Civil Penalty for False Information With Respect to Withholding.—If you make a false statement with no reasonable basis that results in no backup withholding, you are subject to a $500 penalty.

Criminal Penalty for Falsifying Information.— Willfully falsifying certifications or affirmations may subject you to criminal penalties including fines and/or imprisonment.

Misuse of TINs.—If the requester discloses or uses TINs in violation of Federal law, the requester may be subject to civil and criminal penalties.

Specific Instructions

Name.—If you are an individual, you must generally enter the name shown on your social security card. However, if you have changed your last name, for instance, due to marriage, without informing the Social Security Administration of the name change, enter your first name, the last name shown on your social security card, and your new last name.

If the account is in joint names, list first and then circle the name of the person or entity whose number you enter in Part I of the form.

Sole Proprietor.—You must enter your **individual** name as shown on your social security card. You may enter your business, trade, or "doing business as" name on the **business name** line.

Other Entities.—Enter the business name as shown on required Federal tax documents. This name should match the name shown on the charter or other legal document creating the entity. You may enter any business, trade, or "doing business as" name on the business name line.

Part I—Taxpayer Identification Number (TIN)

You must enter your TIN in the appropriate box. If you are a resident alien and you do not have and are not eligible to get an SSN, your TIN is your IRS individual taxpayer identification number (ITIN). Enter it in the social security number box. If you do not have an ITIN, see **How To Get a TIN** below.

If you are a sole proprietor and you have an EIN, you may enter either your SSN or EIN. However, using your EIN may result in unnecessary notices to the requester.

Note: *See the chart on this page for further clarification of name and TIN combinations.*

How To Get a TIN.—If you do not have a TIN, apply for one immediately. To apply for an SSN, get **Form SS-5** from your local Social Security Administration office. Get **Form W-7** to apply for an ITIN or **Form SS-4** to apply for an EIN. You can get Forms W-7 and SS-4 from the IRS by calling 1-800-TAX-FORM (1-800-829-3676).

If you do not have a TIN, write "Applied For" in the space for the TIN, sign and date the form, and give it to the requester. For interest and dividend payments, and certain payments made with respect to readily tradable instruments, you will generally have 60 days to get a TIN and give it to the requester. Other payments are subject to backup withholding.

Note: *Writing "Applied For" means that you have already applied for a TIN* ***OR*** *that you intend to apply for one soon.*

Part II—For Payees Exempt From Backup Withholding

Individuals (including sole proprietors) are **not** exempt from backup withholding. Corporations are exempt from backup withholding for certain payments, such as interest and dividends. For more information on exempt payees, see the separate Instructions for the Requester of Form W-9.

If you are exempt from backup withholding, you should still complete this form to avoid possible erroneous backup withholding. Enter your correct TIN in Part I, write "Exempt" in Part II, and sign and date the form.

If you are a nonresident alien or a foreign entity not subject to backup withholding, give the requester a completed **Form W-8,** Certificate of Foreign Status.

Part III—Certification

For a joint account, only the person whose TIN is shown in Part I should sign (when required).

1. Interest, Dividend, and Barter Exchange Accounts Opened Before 1984 and Broker Accounts Considered Active During 1983. You must give your correct TIN, but you do not have to sign the certification.

2. Interest, Dividend, Broker, and Barter Exchange Accounts Opened After 1983 and Broker Accounts Considered Inactive During 1983. You must sign the certification or backup withholding will apply. If you are subject to backup withholding and you are merely providing your correct TIN to the requester, you must cross out item **2** in the certification before signing the form.

3. Real Estate Transactions. You must sign the certification. You may cross out item 2 of the certification.

4. Other Payments. You must give your correct TIN, but you do not have to sign the certification unless you have been notified that you have previously given an incorrect TIN. "Other payments" include payments made in the course of the requester's trade or business for rents, royalties, goods (other than bills for merchandise), medical and health care services (including payments to corporations), payments to a nonemployee for services (including attorney and accounting fees), and payments to certain fishing boat crew members.

5. Mortgage Interest Paid by You, Acquisition or Abandonment of Secured Property, Cancellation of Debt, or IRA Contributions. You must give your correct TIN, but you do not have to sign the certification.

Privacy Act Notice

Section 6109 of the Internal Revenue Code requires you to give your correct TIN to persons who must file information returns with the IRS to report interest, dividends, and certain other income paid to you, mortgage interest you paid, the acquisition or abandonment of secured property, cancellation of debt, or contributions you made to an IRA. The IRS uses the numbers for identification purposes and to help verify the accuracy of your tax return. The IRS may also provide this information to the Department of Justice for civil and criminal litigation and to cities, states, and the District of Columbia to carry out their tax laws.

You must provide your TIN whether or not you are required to file a tax return. Payers must generally withhold 31% of taxable interest, dividend, and certain other payments to a payee who does not give a TIN to a payer. Certain penalties may also apply.

What Name and Number To Give the Requester

For this type of account:	Give name and SSN of:
1. Individual	The individual
2. Two or more individuals (joint account)	The actual owner of the account or, if combined funds, the first individual on the account [1]
3. Custodian account of a minor (Uniform Gift to Minors Act)	The minor [2]
4. a. The usual revocable savings trust (grantor is also trustee)	The grantor-trustee [1]
b. So-called trust account that is not a legal or valid trust under state law	The actual owner [1]
5. Sole proprietorship	The owner [3]
For this type of account:	**Give name and EIN of:**
6. Sole proprietorship	The owner [3]
7. A valid trust, estate, or pension trust	Legal entity [4]
8. Corporate	The corporation
9. Association, club, religious, charitable, educational, or other tax-exempt organization	The organization
10. Partnership	The partnership
11. A broker or registered nominee	The broker or nominee
12. Account with the Department of Agriculture in the name of a public entity (such as a state or local government, school district, or prison) that receives agricultural program payments	The public entity

[1] List first and circle the name of the person whose number you furnish. If only one person on a joint account has an SSN, that person's number must be furnished.

[2] Circle the minor's name and furnish the minor's SSN.

[3] You must show your individual name, but you may also enter your business or "doing business as" name. You may use either your SSN or EIN (if you have one).

[4] List first and circle the name of the legal trust, estate, or pension trust. (Do not furnish the TIN of the personal representative or trustee unless the legal entity itself is not designated in the account title.)

Note: *If no name is circled when more than one name is listed, the number will be considered to be that of the first name listed.*

Appendix H

Address for Agreement Section 1.B.(9) Documents

One executed original	**Model Release,**
One executed original	**Agreement Regarding Interpretation of Memorandum of Understanding,**
One executed original	**Authorization and Designation of City/County Designees**
One executed original	**Transfer Instructions**, and
One executed original	**Form W-9**

Are to be sent to the State at the following address by each City and each County:

Tobacco Litigation Section
Local Escrow Implementation
Office of the Attorney General
PO Box 944255
Sacramento CA 94244-2550

APPENDIX "I"
(MODEL ESCROW INSTRUCTIONS)

At such time as all events and conditions set forth in Section 3.C of the National Escrow Agreement have been satisfied and the Escrow Agent is notified to release the escrow funds to the States, the Escrow Agent shall disburse all funds held in the "California Account"[1] as follows:

1. All funds allocated to the California Account shall be credited to the following governmental entities in the following percentages:

(a) 50% of the funds allocated to the California Account at the time of release shall be credited to the State of California ("hereinafter the "State").

(b) The remaining funds allocated to the California Account at the time of release shall be credited to the Cities and Counties in the MOU Proportional Allocable Shares indicated in the following chart:

City/County	MOU Proportional Allocable Share
County of Alameda	0.038684912
County of Alpine	0.000033659
County of Amador	0.000908437
County of Butte	0.005507657
County of Calaveras	0.000967681
County of Colusa	0.000492187

[1]All terms herein have the same meaning as, and are defined the same as they are defined in the California State Escrow Agreement. All definitions contained in the California State Escrow Agreement are incorporated by reference herein in these instructions

County of Contra Costa	0.024306394
County of Del Norte	0.000709475
County of El Dorado	0.003810330
County of Fresno	0.020186175
County of Glenn	0.000749939
County of Humboldt	0.003602356
County of Imperial	0.003305532
County of Inyo	0.000552852
County of Kern	0.016435785
County of Kings	0.003068617
County of Lake	0.001531178
County of Lassen	0.000834616
County of Los Angeles	0.268039045
City of Los Angeles	0.025000000
County of Madera	0.002664010
County of Marin	0.006958543
County of Mariposa	0.000432520
County of Mendocino	0.002429787
County of Merced	0.005395248
County of Modoc	0.000292681
County of Mono	0.000301088
County of Monterey	0.010755839
County of Napa	0.003349746
County of Nevada	0.002374293
County of Orange	0.072899828
County of Placer	0.005225682
County of Plumas	0.000596945
County of Riverside	0.035395529
County of Sacramento	0.031488456

County of San Benito	0.001109788
County of San Bernardino	0.042894526
County of San Diego	0.075544785
City of San Diego	0.025000000
City and County of San Francisco	0.046893906
County of San Joaquin	0.014535111
County of San Luis Obispo	0.006567395
County of County of San Mateo	0.019645843
County of Santa Barbara	0.011177653
County of Santa Clara	0.045289595
City of San Jose	0.025000000
County of Santa Cruz	0.006947596
County of Shasta	0.004446650
County of Sierra	0.000100343
County of Siskiyou	0.001316461
County of Solano	0.010294983
County of Sonoma	0.011740576
County of Stanislaus	0.011205295
County of Sutter	0.001948033
County of Tehama	0.001500755
County of Trinity	0.000395050
County of Tulare	0.009433088
County of Tuolumne	0.001465402
County of Ventura	0.020232324
County of Yolo	0.004266892
County of Yuba	0.001760926
	1.000000

2. The amounts credited to the State and to the Cities and Counties pursuant to Section 1 above shall be transferred by wire transfer as follows:

(a) The amount credited to the State shall be wire transferred to the "California State General Fund."

(b) If the State has notified the Escrow Agent that a City or County has attained the status of Eligible City and/or Eligible County, all amounts credited to such Eligible City and/or Eligible County shall be wire transferred to the accounts specified by such Eligible Cities and/or Eligible Counties in the "Transfer Instructions" submitted to the Escrow Agent pursuant to section ___ of the"California State Escrow Agreement" (modeled after section 1.B.(9)(d) of the"Agreement Regarding Interpretation of Memorandum of Understanding").

(c) If the State has not notified the Escrow Agent that a City or County has attained the status of Eligible City and/or Eligible County, all amounts credited to such City and/or County shall be transferred to the "City/County Account" established pursuant to section ___ of the"California State Escrow Agreement" (modeled after section 4.B.(2)(ii) of the "Agreement Regarding Interpretation of Memorandum of Understanding"), and held by the Escrow Agent (along with any earnings thereon), separate and apart from all other funds and accounts of the Escrow Agent, the State, the Eligible Cities, Eligible Counties and the Participating Manufacturers until the Escrow Agent receives further instructions pursuant to section ___ of the California State Escrow Agreement (modeled after section 4.B.(2)(ii) of the "Agreement Regarding Interpretation of Memorandum of Understanding").

Appendix J

Mathematical Example:
State as Responsible Entity
Offset Recouped in One Year

Assumptions: An annual payment of $1,000 is due to be released to the California Account. However, an Original Participating Manufacturer claims an offset of $100 against this payment, because of a judgment obtained by the State on a released claim. The California Account therefore receives a payment of only $900. All Cities and Counties are Eligible Cities/Counties.

Instructions: Absent other instructions, the Escrow Agent would normally divide this amount by giving $450 to the State and $450 to the Cities and Counties. However, pursuant to section 4.C.(2)(a)(i) of this Agreement, the State notifies the Escrow Agent and the City/County Steering Committee that the $100 offset has occurred and that the State is the Responsible Party. The State instructs the Escrow Agent to deduct one-half of the amount of the offset (or $50) from the State's share, and credit that amount to the City and County share. The Escrow Agent therefore transmits $400 to the State and transmits the remaining $500 to the Cities and Counties, pursuant to their MOU Proportional Allocable Shares. Thus all parties are returned to the same position that they would have been in if the offset had not occurred.

Appendix K

Mathematical Example:
City / County as Responsible Entity
Offset Recouped in One Year

Assumptions: An annual payment of $1,000 is due to be released to the California Account. However, an Original Participating Manufacturer claims an offset of $10 against this payment, because of a judgment obtained by the City and County of San Francisco on a released claim. The California Account therefore receives a payment of only $990. Based on the 1990 Official United States Decennial Census, San Francisco's MOU Proportional Allocable Share is equal to 4.6893906% of the total money to be split among the Cities and Counties. All Cities and Counties are Eligible Cities/Counties.

Instructions: Absent other instructions, the Escrow Agent would normally divide the $990 payment by giving $495 to the State and $495 to the Cities and Counties. However, pursuant to section 4.C.(2)(a)(ii) of this Agreement, the State notifies the Escrow Agent and the City/County Steering Committee that the $10 offset has occurred and that San Francisco is the Responsible Entity. The State instructs the Escrow Agent to deduct one-half of the amount of the offset (or $5) from the City/County share and credit that amount to the State share. The Escrow Agent therefore transmits $500 to the State and divides the remaining $490 among the Cities and Counties. The State further instructs the Escrow Agent to deduct the full amount of the offset ($10) from the amount that would normally be paid to San Francisco pursuant to its MOU Proportional Allocable Share, and to redistribute this amount to all Cities and Counties (including San Francisco) pursuant to their MOU Proportional Allocable Shares. This is demonstrated graphically as follows:

Step 1: Divide California Payment 50/50 between the State and the Cities and Counties.

(a) $990 / 2 = $495 (State Share)
$495 (City/County Share)

Step 2: Calculate the Base MOU Proportional Allocable Shares of the Cities and Counties ("City/County Base MPAS") by multiplying the City/County Share by the MOU Proportional Allocable Share percentages ("MPAS%").

(a) City/County Share x MPAS% = City/County Base MPAS

(b) Repeat for each City and County

(c) San Francisco's Base MPAS is: $495 x .046893906 = $23.21248347

Step 3: Deduct ½ of the offset amount from the Responsible Entity's Base MPAS and adjust the State Share by adding this amount to the State Share.

(a) State Share + (Offset Amount / 2) = Adjusted State Share

(b) Under this example, the Adjusted State Share is:
$495 + ($10 / 2) = $500

(c) San Francisco's Adjusted Base MPAS is:
$23.21248347 - $5 = $18.21248347

Step 4: Deduct the remaining ½ of the offset amount from the Responsible Entity's Base MPAS and adjust the Cities' and Counties' Base MPAS by adding their MPAS% of this amount to their respective Base MPAS.

(a) [(Offset Amount / 2) x MPAS%] + Base MPAS = City/County Adjusted Base MPAS

(b) Repeat for each City and County

(c) San Francisco's Adjusted Base Amount is:
[($10 / 2) x .046893906] + ($18.21248347 - 5) = $13.446953

Appendix L

Mathematical Example:
State as Responsible Entity
Offset Not Recouped in First Year

Assumptions: An annual payment of $1,000 is due to be released to the California Account. However, an Original Participating Manufacturer claims an offset of $750 against this payment, because of a judgment obtained by the State on a released claim. The California Account therefore receives a payment of only $250. The next year, the California account receives its regular annual payment of $1,000. The applicable rate of interest pursuant to section 4.C.(1)(b) of this Agreement is assumed to be 5%. All Cities and Counties are Eligible Cities/Counties.

Instructions: Absent other instructions, the Escrow Agent would normally divide this amount by giving $125 to the State and $125 to the Cities and Counties. However, pursuant to section 4.C.2(b)(i) of this Agreement, the State notifies the Escrow Agent and the City/County Steering Committee that the $750 offset has occurred and that the State is the Responsible Entity. The State instructs the Escrow Agent to deduct one-half of the amount of the offset (or $375) from the State's share. Since this exceeds the amount of the State's share, the State instructs the Escrow Agent to credit the entire amount of its payment for the year to the City and County share, and to deduct the unreimbursed amount ($250, plus interests as described in section 4.C.(1)(b) of this Agreement) from its next payment(s). In the first year, the Escrow Agent therefore transmits nothing to the State and distributes the entire $250 to the Cities and Counties, pursuant to their MOU Proportional Allocable Shares. In the next year, the Escrow Agent will deduct $250 (plus $12.5 in interest at the hypothetical rate of 5%) from the State's share, and credit this amount to the Cities'/Counties' share. Thus the State will receive $237.5 and the Cities/Counties will receive $762.5. Including the money the State received directly from the Original Participating manufacturer, the two year cash flow would be as follows:

Year	State	Cities and Counties
1	$750	$250
2	$237.5	$762.5
Total:	$987.5	$1,012.5

Thus in effect, the State receives an advance of settlement funds in the first year, and pays this advance back to the Cities and Counties, with interest, in the second year.

Appendix M

Mathematical Example:
City / County as Responsible Entity
Offset Not Recouped in First Year

Assumptions: An annual payment of $1,000 is due to be released to the California Account. However, an Original Participating Manufacturer claims an offset of $40 against this payment, because of a judgment obtained by the City and County of San Francisco on a released claim. The California Account therefore receives a payment of only $960. The next year, the California account receives its regular annual payment of $1,000. The applicable rate of interest pursuant to section 4.C.(1)(b) of this Agreement is assumed to be 5%. Based on the 1990 Official United States Decennial Census, San Francisco's MOU Proportional Allocable Share is equal to 4.6893906% of the total money to be split among the Cities and Counties. The remaining Cities and Counties have a combined MOU Proportional Allocable Share of 95.3106094. All Cities and Counties are Eligible Cities/Counties.

Instructions: Absent other instructions, the Escrow Agent would normally divide the $960 payment by giving $480 to the State and $480 to the Cities and Counties. San Francisco's MOU Proportional Allocable Share of $480 would be $22.50. However, pursuant to section 4.C.(2)(b)(ii) of this Agreement, the State notifies the Escrow Agent and the City/County Steering Committee that the $40 offset has occurred and that San Francisco is the Responsible Entity. Since the amount of the offset exceeds San Francisco's MOU Proportional Allocable Share, the State instructs the Escrow Agent to credit the State with one-half of San Francisco's MOU Proportional Allocable Share ($11.25), and to credit the Cities and Counties (excluding San Francisco) with the other half ($11.25). The State further instructs the Escrow Agent to calculate San Francisco's MOU Proportional Allocable Share of the amount credited to the Cities and Counties ($11.25 x .046893906 = $.52), and credit one-half of this amount ($.26) to the State and one-half to the Cities and Counties (excluding San Francisco). Thus in the first year, the Escrow Agent pays nothing to San Francisco, pays $491.51 to the State [$480.00 + $11.25 + $.26 = 491.51), and divides 468.49 [$480 – 11.25 - .26 + = 468.49] among the Cities and Counties (excluding San Francisco), based on their pro rata MOU Proportional Allocable Shares. The State further instructs the Escrow Agent to deduct the unreimbursed amount [$40 – 22.50 - .52 = 16.98] plus interest as described in section 4.C.(1)(b) of this Agreement) from the next payment(s) due to San Francisco. In the second year, the Escrow Agent will deduct $16.98 (plus $.84 in interest at the hypothetical rate of 5%, for a total deduction of $17.82) from San Francisco's share, and credit one-half of this amount ($8.91) to the State and one-half to the to the Cities'/Counties' share, to be redistributed to all Cities and Counties (including San Francisco) based on their MOU Proportional Allocable Share. San Francisco therefore receives a payment in the second year equal to:

($500 x .046893906) – 17.82 + ($8.91 x .046893906) =
(23.44) – 17.82 + (0.42) = 6.04

The State will receive $508.91. The Cities and Counties other than San Francisco receive: 500 –23.44 + 8.91 - .42 = 485.05. Including the money that San Francisco received in the first year directly from the Original Participating Manufacturer (thereby triggering the offset), the two year cash flow would be as follows:

Year	State	San Francisco	Other Cities and Counties
1	$491.51	$40.	468.49
2	$508.91	$ 6.04	485.05
Total:	$1,000.42	$46.04	953.54
2 yr. av.	$1,000.	$46.88	953.12
Difference	+.42	-.84	+.42

Because San Francisco has to pay interest, it receives $.84 less than its normal two-year allocation (which is 23.44 x 2 = 46.88) but it receives the bulk of its money sooner. Conversely, because the State and the other Cities and Counties are paid interest, they receive $.42 more than their normal two-year allocation [$1,000 for the State, $953.12 for the other Cities and Counties], but they get less in the first year.

This is demonstrated graphically as follows:

Step 1: Divide California Payment 50/50 between the State and the Cities and Counties.

(a) $960 / 2 = $480 (State Share)
$480 (City/County Share)

Step 2: Calculate the Base MOU Proportional Allocable Shares of the Cities and Counties ("City/County Base MPAS") by multiplying the City/County Share by the MOU Proportional Allocable Share percentages ("MPAS%").

(a) City/County Share x MPAS% = City/County Base MPAS

(b) Repeat for each City and County

(c) San Francisco's Base MPAS is: $480 x .046893906 = $22.50907488

Step 3: Deduct ½ of the Responsible Entity's Base MPAS and adjust the State Share by adding this amount to the State Share.

(a) State Share + (Responsible Entity Base MPAS / 2) = Adjusted State Share

(b) Under this example, the Adjusted State Share is:
$480 + ($22.50907488 / 2) = $491.25

Step 4: Deduct the remaining ½ of the Responsible Entity's Base MPAS and adjust the Cities' and Counties' Base MPAS by adding their MPAS% of this amount to their respective Base MPAS.

(a) [(Responsible Entity's Base MPAS / 2) x MPAS%] + Base MPAS = City/County Adjusted Base MPAS

(b) Repeat for each City and County

(c) San Francisco's Adjusted Base Amount is:
[($22.50907488 / 2) x .046893906 + 0] = $.5277692189091

Step 5: Deduct ½ of the Responsible Entity's Adjusted Base MPAS and adjust the Adjusted State Share by adding this amount to the State Share.

(a) Adjusted State Share + (Responsible Entity Adjusted Base MPAS / 2) = State Distribution

(b) Under this example, the State Distribution is:
$491.25 + ($.5277692189091 / 2) = $491.51

Step 6: Calculate the Enhanced MPSA% of each City and County (except the Responsible Entity) by their proportional share of the Responsible Entity's MPAS% to their respective MPAS%.

(a) Individual MPAS% / Combined MPAS% (excluding Responsible Entity)[1] = Enhanced MPAS%

(b) Repeat for each City and County

Step 7: Deduct the remaining ½ of the Responsible Entity's Adjusted Base MPAS and adjust the Cities' and Counties' Adjusted Base MPAS by adding their Enhanced MPAS% of this amount to their respective Adjusted Base MPAS.

(a) [(Responsible Entity's Adjusted Base MPAS / 2) x Enhanced MPAS%] + City/County Adjusted Base MPAS = City/County Distribution

(b) Repeat for each City and County

(c) San Francisco's Distribution is $0

Step 8: Calculate Principal owed by the Responsible Entity and begin time for interest to run on amount owed.

(a) Offset Amount - Responsible Entity's Base MPAS - Responsible Entity's Adjusted Base MPAS = Principal Amount Owed

(b) San Francisco's Principal owed is: $40 - $22.50 - $.52 = $16.98

Step 9: At time of next payment by the Tobacco Industry, calculate principal and interest owed by the Responsible Entity.

(a) Principal Owed + Interest on Principal Since Last Distribution = Offset Amount

(b) San Francisco's Offset owed at the time of the next payment is: $16.98 + $.84 = $17.82

Step 10: (see following page)

[1]Under this example, the Combined MPAS% is: 1 - .046893906 = .953106094

Step 10: Deduct the Offset Owed from the Responsible Entity's MPAS of the second year payment and divide this amount 50/50 between State and Cities and Counties. If the amount owed is less than the Responsible Entity's MPAS, then utilize redistribution methodology embodied in "Appendix K." If the amount owed is greater than the Responsible Entity's MPAS, then utilize redistribution methodology embodied in this Appendix M.

(a) Under this example, the year two Adjusted State Share would be:
($1000 / 2) + ($17.82 / 2) = $508.91

(b) Under this example, the year two Cities' and Counties' Adjusted MPAS would be:
[($1000 / 2) x MPAS%] + [($17.82 / 2) x MPAS%]
= City/County Adjusted MPAS

(c) In year two, San Francisco would receive:
([($1000 / 2) x .046893906] - $17.82) + [($17.82 / 2) x 046893906] = $6.04

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General
CORINNE MURPHY
Deputy Attorney General
State Bar No.
1300 I Street
P.O. Box 944255
Sacramento, CA 94244-2550
Telephone: (916) 324-5346
Fax: (916) 323-0813
Attorneys for Plaintiffs

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN DIEGO

CENTRAL

PEOPLE OF THE STATE OF CALIFORNIA ex rel. DANIEL E. LUNGREN, ATTORNEY GENERAL OF THE STATE OF CALIFORNIA; S. KIMBERLY BELSHÉ, DIRECTOR OF HEALTH SERVICES OF THE STATE OF CALIFORNIA,

Plaintiffs,

v.

PHILIP MORRIS, INC.; R.J. REYNOLDS TOBACCO COMPANY; BROWN & WILLIAMSON TOBACCO CORPORATION; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY; LORILLARD TOBACCO COMPANY, INC.; AMERICAN TOBACCO COMPANY, INC.; UNITED STATES TOBACCO COMPANY; HILL & KNOWLTON, INC.; THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC.; TOBACCO INSTITUTE, INC.; SMOKELESS TOBACCO COUNCIL, INC. and DOES 1-200, inclusive,

Defendants.

J.C.C.P. 4041

(Sacramento Superior Court Case No: 97AS03031)

NOTICE OF MOTION AND MOTION FOR APPROVAL OF AMENDMENT TO THE AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING APPLICABLE ONLY TO THE STATE OF CALIFORNIA AND EACH ELIGIBLE CITY OR COUNTY THAT EXECUTES THE SAME; MEMORANDUM OF POINTS AND AUTHORITIES

Date: June 3, 2001
Time: 3:00 p.m.
Dept: 69
Judge: Ronald S. Prager

PLEASE TAKE NOTICE that on June 3, 2001, at 3:00 p.m., the Honorable Ronald S. Prager, will issue a telephonic ruling on the joint motion of the People of the State of California and the Counties of Sacramento and San Diego for an order approving the "Amendment to Agreement Regarding Interpretation of Memorandum of Understanding Affecting Only the State of California and Each Eligible City and Eligible County Which Is a Signatory Hereto," (Exhibit A), which is necessary to facilitate the Securitization Transactions contemplated by certain Eligible Cities and/or Counties.

Plaintiff's motion will be based on this Notice of Motion, Memorandum of Points and Authorities, and all papers, pleadings and records on file in this action and on such other and further argument and evidence as may be presented.

///

///

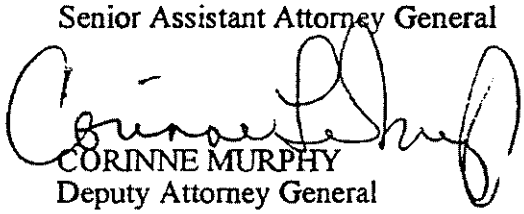
///

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-1331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: 4/26, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General



CORINNE MURPHY
Deputy Attorney General
Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO
ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO
JOHN J. SANSOME
County Counsel

WILLIAM SMITH
Deputy County Counsel

MEMORANDUM OF POINTS AND AUTHORITIES

On December 9, 1998, this Court entered the Consent Decree and Final Judgment ("Consent Judgment"), approving the terms of the Master Settlement Agreement ("MSA") reached

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-1331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General
Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO
ROBERT A. RYAN, JR.
County Counsel

M. Holly Gilchrist
M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO
JOHN J. SANSOME
County Counsel

WILLIAM SMITH
Deputy County Counsel

MEMORANDUM OF POINTS AND AUTHORITIES

On December 9, 1998, this Court entered the Consent Decree and Final Judgment ("Consent Judgment"), approving the terms of the Master Settlement Agreement ("MSA") reached

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-1331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General
Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO
ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO
JOHN J. SANSOME
County Counsel

William Smith

WILLIAM SMITH
Deputy County Counsel

MEMORANDUM OF POINTS AND AUTHORITIES

On December 9, 1998, this Court entered the Consent Decree and Final Judgment ("Consent Judgment"), approving the terms of the Master Settlement Agreement ("MSA") reached

between the Attorneys General of 46 states, 5 territories, the District of Colombia, and the tobacco industry. Pursuant to the terms of the Memorandum of Understanding ("MOU"), which was also approved as part of the Consent Decree, the Attorney General on behalf of the People agreed to share a portion of the tobacco settlement funds coming to the State of California through the MSA with all California Counties and the Cities of Los Angeles, San Diego, San Francisco, and San Jose ("Cities and Counties"). Pursuant to paragraph VI(A) of the Consent Decree and Final Judgment, this Court retained continuing jurisdiction to implement the settlement.

In December 1999, the People and the California Cities and Counties prosecuting tobacco claims in J.C.C.P. 4041 asked this Court to enter an order approving a further document, the Agreement Regarding Interpretation of Memorandum of Understanding ("ARIMOU"), which was necessary to implement disbursal of tobacco settlement proceeds to the Eligible Cities and Counties. That order was entered on January 18, 2000. The ARIMOU was executed by all the Cities and Counties. The State, through the Attorney General, entered into an agreement with Citibank, N.A., to act as escrow agent to disburse half of the tobacco settlement proceeds to the Cities and Counties. Several disbursements have already been made in accordance with these agreements.

The Counties of Sacramento and San Diego are contemplating "securitization" transactions by which they would sell their rights to receive some or all of their shares of the settlement proceeds. To effect such a sale, the counties must place restrictions on their ability to change the transfer instructions they give the Attorney General, which the Attorney General passes on to the escrow agent for the disbursal of funds. Although the ARIMOU provides for amending transfer instructions, it does not provide for the type of amendment necessary to effectuate the sale of this asset.

By this motion, the State and the Counties of San Diego and Sacramento ask this Court to enter an order approving an amendment to the ARIMOU which will provide a modified procedure regarding transfer instructions, which will be applicable to the State of California on one hand and each City or County that elects to become a signatory thereto.

///

///

ARGUMENT

On August 5, 1998, the Cities and Counties which were litigating against the Tobacco Industry in the J.C.C.P. 4041 action reached agreement with the Attorney General, regarding joint prosecution of tobacco claims against the tobacco industry. This agreement was embodied in the MOU which, along with the MSA, was approved by this Court on December 9, 1998, as Exhibit B to the Consent Judgment. The MOU provides that if the parties received a monetary award, whether by settlement or trial, the monetary recovery would be divided equally between the State and the Cities and Counties. By virtue of the MOU, the Cities and Counties receive 50% of all tobacco settlement proceeds received by California pursuant to the MSA. The Cities and Counties, which are parties to the J.C.C.P. 4041 Coordinated Proceedings negotiated the ARIMOU to implement the process by which the Cities and Counties receive their share of the tobacco settlement proceeds. On January 18, 2000, the ARIMOU was approved by order of this Court.

The Counties of San Diego and Sacramento now contemplate a "securitization" transaction, in which each of them would sell its right to receive its MOU Proportional Allocable Share of the settlement payments to a non-profit corporation or other transferee. The buyer would raise money to purchase the share(s) by borrowing it from a joint powers authority. The authority, whose members would be two or more of the Eligible Cities and Counties, would issue bonds to generate money to loan to the buyer. The buyer would use the proceeds of the bond sale to pay the purchase price to the city or county that is selling its share of the settlement. As part of the transaction, related bonds will be issued under an indenture between the relevant authority and a trustee (the "Indenture Trustee"). The share of the settlement payments of a participating city or county would be pledged to secure repayment of the related bonds.

Once the related bonds are issued and so long as they are outstanding, the city or county will need to provide that its share of the settlement payments are to be transferred directly to the Indenture Trustee by the Escrow Agent. Thus, so long as such bonds are outstanding, the city or county will need to agree that no further transfer instructions may be given to the State for transmission to the escrow agent unless they are countersigned by a representative of the Indenture Trustee. The city or county will also need to agree that, after the related bonds are repaid, any further

transfer instructions must be countersigned by the relevant buyer (or any successor transferee). It is anticipated that other Eligible Cities and Eligible Counties may also decide to engage in a securitization transaction.

The ARIMOU currently provides that the State shall instruct the Escrow Agent to disburse each Eligible City's and/or Eligible County's MOU Proportional Allocable Share to a single account as specified pursuant to instructions received by the State from the Eligible City or Eligible County. This account information must be given in the form of Transfer Instructions jointly executed by two of the three designees for the Eligible City or Eligible County. (ARIMOU, § 4.B.(2)(i)(aa) and Appendix F). This motion seeks court approval of an amendment to section 4.B.(2)(i)(bb) to add the following paragraph at the end of the present text:

> "Modifications to instructions described in Section 4.B.(2)(i)(aa) above may contain instructions that the same may not be further modified without the counter signature of a third party designated in the instructions including but not limited to, an indenture trustee for bonds secured by the MOU Proportional Allocable Share of an Eligible City or Eligible County or a transferee to which an MOU Proportional Allocable Share has been sold or otherwise assigned or disposed of."

(See proposed "Agreement Regarding Interpretation of Memorandum of Understanding Affecting Only the State of California and Each Eligible City and Eligible County Which Is a Signatory Hereto," attached as Exhibit A).

///

///

///

CONCLUSION

For all of the above reasons, the State and the Counties of San Diego and Sacramento jointly request that the Court approve the Amendment to the ARIMOU and enter the order submitted with this motion.

Dated: 4/26, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California

RICHARD M. FRANK
Chief Assistant Attorney General

DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General

Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO

ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO

JOHN J. SANSOME
County Counsel

WILLIAM SMITH
Deputy County Counsel

CONCLUSION

For all of the above reasons, the State and the Counties of San Diego and Sacramento jointly request that the Court approve the Amendment to the ARIMOU and enter the order submitted with this motion

Dated: _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California

RICHARD M. FRANK
Chief Assistant Attorney General

DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General

Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO

ROBERT A. RYAN, JR.
County Counsel

M. Holly Gilchrist

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO

JOHN J. SANSONE
County Counsel

WILLIAM SMITH
Deputy County Counsel

CONCLUSION

For all of the above reasons, the State and the Counties of San Diego and Sacramento jointly request that the Court approve the Amendment to the ARIMOU and enter the order submitted with this motion.

Dated: ___ _ _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California

RICHARD M. FRANK
Chief Assistant Attorney General

DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General

Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO

ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO

JOHN J. SANSONE
County Counsel

William Smith

WILLIAM SMITH
Deputy County Counsel

EXHIBIT A

AMENDMENT TO AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING AFFECTING ONLY THE STATE OF CALIFORNIA AND EACH ELIGIBLE CITY AND ELIGIBLE COUNTY WHICH IS A SIGNATORY HERETO

This Amendment to Agreement Regarding Interpretation of Memorandum of Understanding affecting only the State of California (the "State") and each Eligible City and Eligible County which is a signatory hereto.

W I T N E S S E T H

WHEREAS, the State, four cities, fifty-seven counties and one city and county have heretofore become signatories to an Agreement Regarding Interpretation of the Memorandum of Understanding (the "ARIMOU") which was approved by the J.C.C.P. 4041 Court on January 18, 2000; and

WHEREAS, the ARIMOU provides interpretations of an agreement entitled Memorandum of Understanding (the "MOU"), attached as Appendix A to the ARIMOU, to which the State as well as others, are parties; and

WHEREAS, one of the purposes of the ARIMOU is to specify the procedures by which funds allocated to Cities and Counties pursuant to the MOU are to be transferred to Cities and Counties by the Escrow Agent; and

WHEREAS, Section 4 of the ARIMOU contemplates that with respect to an Eligible City or an Eligible County, the transfer instructions are limited to providing only bank routing information as to the Account into which a transfer is to occur; and

WHEREAS, one or more of each Eligible City and Eligible County contemplate series of transactions (each such series a "Securitization Transaction") in which each of them would sell its right to receive its MOU Proportional Allocable Shares to a non-profit corporation or other transferee (each a "Buyer") which in turn would borrow the money to purchase the same from joint powers authorities (each an "Authority"), the members of which will be two or more of the Eligible Cities and Eligible Counties, and each Authority would issue bonds (collectively, the "Bonds" and individually the "Related Bonds") to generate the proceeds to loan to each Buyer which in

turn would use the proceeds to pay the purchase price to the Eligible City or Eligible County selling the same; and

WHEREAS, in a Securitization Transaction, Related Bonds will be issued under an indenture between the relevant Authority and a trustee (the "Indenture Trustee"); and

WHEREAS, in a Securitization Transaction, the MOU Proportional Allocable Share of a participating Eligible City or Eligible County will be pledged to secure repayment of the Related Bonds; and

WHEREAS, in a Securitization Transaction, each participating Eligible City or Eligible County will wish to provide that, once the Related Bonds are issued as herein-above described, and so long as the Related Bonds are outstanding, all amounts of its MOU Proportional Allocable Share are to be transferred directly to the Indenture Trustee for the Related Bonds, and that, so long as such Bonds are outstanding, no further transfer instructions may be provided to the State for transmission to the Escrow Agent unless countersigned by a representative of the Indenture Trustee and, after the Related Bonds are repaid, unless countersigned by the relevant Buyer (or any successor transferee); and

WHEREAS, the State wishes to amend the ARIMOU as it relates to the State on the one hand and each Eligible City and Eligible County contemplating a Securitization Transaction so as to permit instructions to the Escrow Agent under Section 4 of the ARIMOU given by such Eligible City or Eligible County, as the case may be, to limit modifications to transfer instructions only to modifications counter-signed or otherwise approved by the relevant Indenture Trustee, the relevant Buyer, or any successor in interest to either;

NOW, THEREFORE, THE PARTIES HERETO AGREE AS FOLLOWS:

SECTION 1: DEFINITIONS

All capitalized terms used herein which are not defined herein shall have the meanings attributed to them in the ARIMOU.

///

SECTION 2: SUBSTANTIVE AMENDMENTS

Effective upon execution and delivery hereof and following approval by the J.C.C.P 4041 Court, Section 4.A(2)(i)(bb), of the ARIMOU shall be amended by adding the following at the end of the present text: "Modifications to instructions described in Section 4.B.(2)(i)(aa) above may contain instructions that the same may not be further modified without the counter signature of a third party designated in the instructions including but not limited to, an indenture trustee for bonds secured by the MOU Proportional Allocable Share of an Eligible City or Eligible County or a transferee to which an MOU Proportional Allocable Share has been sold or otherwise assigned or disposed of."

SECTION 3: APPLICABILITY

Subject to approval by the J.C.C.P. 4041 Court, the provisions of this Amendment shall only apply to the State on the one hand and each Eligible City and Eligible County executing the same, and shall be effective as to each such Eligible City and Eligible County upon execution and delivery to the State of one or more counterparts by the State and such Eligible City and Eligible County.

SECTION 4: COUNTERPARTS

This Amendment may be executed in two or more counterparts each of which collectively shall comprise the original of this Amendment.

IN WITNESS WHEREOF, each of the State and each signatory Eligible City and Eligible County has executed this Agreement as of the date set forth opposite the name of each such signatory on the signature pages.

Dated:_____ [ELIGIBLE CITY/ELIGIBLE COUNTY]

By:_____

Dated:_____ STATE OF CALIFORNIA

By:_____

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General
CORINNE MURPHY
Deputy Attorney General
State Bar No.
1300 I Street
P.O. Box 944255
Sacramento, CA 94244-2550
Telephone: (916) 324-5346
Fax: (916) 323-0813
Attorneys for Plaintiffs

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN DIEGO

CENTRAL

PEOPLE OF THE STATE OF CALIFORNIA ex rel. DANIEL E. LUNGREN, ATTORNEY GENERAL OF THE STATE OF CALIFORNIA; S. KIMBERLY BELSHÉ, DIRECTOR OF HEALTH SERVICES OF THE STATE OF CALIFORNIA,

Plaintiffs,

v.

PHILIP MORRIS, INC.; R.J. REYNOLDS TOBACCO COMPANY; BROWN & WILLIAMSON TOBACCO CORPORATION; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY; LORILLARD TOBACCO COMPANY, INC.; AMERICAN TOBACCO COMPANY, INC.; UNITED STATES TOBACCO COMPANY; HILL & KNOWLTON, INC.; THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC.; TOBACCO INSTITUTE, INC.; SMOKELESS TOBACCO COUNCIL, INC. and DOES 1-200, inclusive,

Defendants.

J.C.C.P. 4041

(Sacramento Superior Court Case No: 97AS03031)

(PROPOSED) ORDER APPROVING AMENDMENT TO AGREEMENT REGARDING INTERPRETATION OF MOU

Date: June 3, 2001
Time: 3:00 p.m.
Dept: 69
Judge: Ronald S. Prager

WHEREAS the Court has considered all the papers filed in regard to the Motion for Approval of Amendment to the Agreement Regarding Interpretation of Memorandum of Understanding Applicable only to the State of California and each Eligible City or County that Executes Same;

WHEREAS there will continue to be payments from the National Escrow Account for the benefit of the Eligible Cities and Eligible Counties which will be transferred to accounts in accordance with transfer instructions executed in accordance with the ARIMOU;

WHEREAS one or more Eligible Cities or Eligible Counties contemplates completing a Securitization Transaction;

WHEREAS in a Securitization Transaction, each participating Eligible City or Eligible County will wish to provide that, once the related bonds are issued, and so long as the related bonds are outstanding, all amounts of its MOU Proportional Allocable Share are to be transferred directly to the Indenture Trustee for the related bonds, and that, so long as such Bonds are outstanding, no further transfer instructions may be provided to the State for transmission to the Escrow Agent unless countersigned by a representative of the Indenture Trustee and, after the related bonds are repaid, unless countersigned by the relevant Buyer (or any successor transferee); and

WHEREAS the proposed Amendment to the ARIMOU would provide the mechanism to make such provisions in the transfer instructions as to the State on the one hand and each Eligible City or County that executes the Amendment;.

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

A. The Court has continuing jurisdiction over the subject matter of this action pursuant to the Consent Decree and Final Judgment.

B. The Court finds that the Amendment to the Agreement Regarding Interpretation of Memorandum of Understanding is reasonable and necessary to permit an Eligible City or County, desiring to securitize its share of the tobacco settlement payments, to do so.

C. The proposed amendment to the ARIMOU is approved in all respects.

D. Upon execution of the proposed amendment by the Attorney General on behalf of the People of the State of California and the authorized representative of any Eligible County or Eligible City of the Amendment, that City or County may provide transfer instructions to the State of California consistent with the terms of the amendment.

Dated:_____

_____
RONALD S. PRAGER
Judge of the Superior Court

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: **People of the State of California v. Philip Morris** No.: **J.C.C.P. 4041**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service that same day in the ordinary course of business.

On April 26, 2001, I served the attached **NOTICE OF MOTION AND MOTION FOR APPROVAL OF AMENDMENT TO THE AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING APPLICABLE ONLY TO THE STATE OF CALIFORNIA AND EACH ELIGIBLE CITY OR COUNTY THAT EXECUTES THE SAME; MEMORANDUM OF POINTS AND AUTHORITIES; AND (PROPOSED) ORDER APPROVING AMENDMENT TO AGREEMENT REGARDING INTERPRETATION OF MOU** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the internal mail collection system at the Office of the Attorney General at 1300 I Street, P.O. Box 944255, Sacramento, California 94244-2550, addressed as follows:

See Attached Service List

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on April 26, 2001, at Sacramento, California.

Christina Micherone
Declarant

Christina Micherone
Signature

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

AMERICAN TOBACCO CO.
Robert G. Steiner, Esq.
Christopher J. Healey, Esq.
LUCE, FORWARD, HAMILTON & SCRIPPS
600 West Broadway, Suite 2600
San Diego, CA 92101-3391

Mary T. Yelenick, Esq.
CHADBOURNE & PARKE
30 Rockefeller Plaza
New York, NY 10112

F. John Nyhan, Esq.
CHADBOURNE & PARKE
601 South Figueroa Street, Suite 1600
Los Angeles, CA 90017

B.A.T INDUSTRIES P.L.C.
Barry W. Lee, Esq.
Robert B. Mison, Esq.
STEEFEL, LEVITT & WEISS
One Embarcadero Center, 30th Floor
San Francisco, CA 94111

Jayma M. Meyer
Mark G. Cunha, Esq.
Demetra Frawketm Esq.
Marc Merriweather, Esq.
SIMPSON, THACHER & BARTLETT
425 Lexington Avenue
New York, NY 10017-3909

BROWN & WILLIAMSON TOBACCO
AMERICAN TOBACCO COMPANY
Anthony R. Delling, Esq.
PILLSBURY, MADISON & SUTRO, LLP
725 S. Figueroa Street, Ste. 1200
Los Angeles, CA 90017

BROWN & WILLIAMSON TOBACCO
Kevin J. Dunne, Esq.
Fred Baker, Esq.
SEDGWICK, DETERT, MORAN & ARNOLD
One Embarcadero Center, 16th Floor
San Francisco, CA 94111-3765

Tony L. Richardson, Esq.
KIRKLAND & ELLIS
300 South Grand Avenue, Suite 3000
Los Angeles, CA 90071

Michael J. Weaver, Esq.
Timothy B. Taylor, Esq.
Carrier Battilega, Esq.
SHEPPARD, MULLIN, RICHTER & HAMPTON
501 West Broadway, 19th Floor
San Diego, CA 92101-3035

Bradley E. Lerman, Esq.
Bart Huff, Esq.
KIRKLAND & ELLIS
200 East Randolph Drive
Chicago, IL 60601

COUNCIL FOR TOBACCO RESEARCH – U.S.A., INC.
LIGGETT GROUP, INC.
Daniel G. Murphy, Esq.
LOEB & LOEB
1000 Wilshire Blvd., #1800
Los Angeles, CA 90017-2475

COUNCIL FOR TOBACCO RESEARCH – U.S.A., INC.
Bruce Merritt, Esq.
DEBEVOISE & PLIMPTON
875 Third Avenue
New York, NY 10022

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

HILL & KNOWLTON, INC.
Meryl L. Young, Esq.
GIBSON, DUNN & CRUTCHER
401 West A Street, Suite 1900
San Diego, CA 92101

Stan G. Roman, Esq.
KRIEG KELLER SLOAN REILLEY & ROMAN
114 Sansome Street 7th Floor
San Francisco, CA 94104

Michael C. Lasky, Esq.
Bruce Ginsberg, Esq.
DAVIS & GILBERT
1740 Broadway
New York, NY 10019

LIGGETT GROUP, INC.
James J. Stricker, Esq.
Aaron H. Marks, Esq.
KASOWITZ, BENSON, TORRES & FRIEDMAN
1301 Avenue of Americas
New York, NY 10019

Jeffrey P. Lendrum, Esq.
THE LENDRUM LAW FIRM
550 West C Street, Suite 1360
San Diego, CA 92101

LORILLARD TOBACCO COMPANY
Larry E. Hays, Esq.
FENTON & KELLER
2801 Monterey Salinas Highway
Monterey, CA 93940

LORILLARD TOBACCO COMPANY
H. Christian L'Orange, Esq.
ALLEN MATKINS LECK GAMBLE & MALLORY
333 Bush Street, 17th Floor
San Francisco, CA 94104

Bruce R. Tepikian, Esq.
John C. Monica, Esq.
Craig E. Proctor, Esq.
SHOOK, HARDY & BACON, LLP
One Market
Steuart Tower, Ninth Floor
San Francisco, CA 94105

Sterling Hutcheson, Esq.
William S. Boggs, Esq.
Brian Foster, Esq.
GRAY, CARY, WARE & FREIDENRICH
401 B Street, Suite 1700
San Diego, CA 92101-4219

PHILIP MORRIS, INC.
James F. Speyer, Esq.
Maurice A. Leiter, Esq.
John D. Lombardo, Esq.
ARNOLD & PORTER
777 S. Figueroa Street, 44th Floor
Los Angeles, CA 90071-5844

Joseph S. Genshlea, Esq.
WEINTRAUB, GENSHLEA & SPROUL
400 Capitol Mall, 11th Floor
Sacramento, CA 95814

Gerald L. McMahon, Esq.
Joyce McCoy, Esq.
SELTZER, CAPLAN, WILKINS & McMAHON
750 B Street, Suite 2100
San Diego, CA 92101

PHILIP MORRIS, INC.
Curtis M. Caton, Esq.
Barry S. Levin, Esq.
HELLER, EHRMAN, WHITE & McAULIFFE
333 Bush Street, Suite 3100
San Francisco, CA 94104-2878

R.J. REYNOLDS TOBACCO CO.
H. Joseph Escher III, Esq.

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN
Three Embarcadero Center, 7th Floor
San Francisco, CA 94111-4065

Robert McDermott, Jr., Esq.
Barbara McDowell, Esq.
JONES, DAY, REAVIS & POGUE
51 Louisiana Avenue NW
Washington, D.C. 20001

Robert C. Weber, Esq.
William T. Plesec, Esq.
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, OH 44114

Robert C. Wright, Esq.
Joseph T. Ergastolo, Esq.
WRIGHT & L'ESTRANGE
Imperial Bank Tower
701 B Street, Suite 1500
San Diego, CA 92101

SMOKELESS TOBACCO COUNCIL, INC.
Barry S. Schaevitz, Esq.
JACOB, MEDINGER & FINNEGAN, LLP
Rockefeller Center
1270 Avenue of the Americas
New York, NY 10020

SMOKELESS TOBACCO COUNCIL, INC.
Malcolm S. Segal, Esq.
SEGAL & KIRBY
770 L Street, Ste. 1440
Sacramento, CA 95814

TOBACCO INSTITUTE, INC.
Howard A. Janssen, Esq.
Mary C. Oppedahl, Esq.

CROSBY, HEAFEY, ROACH & MAY
1999 Harrison Street
Oakland, CA 94612-3517

John Vanderstar, Esq.
Patrick Davies, Esq.
R. Laird Hart, Esq.
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2401

UNITED STATES TOBACCO COMPANY
R.J. Couglan, Jr., Esq.
Michael L. Lipman, Esq.
Duane Tyler, Esq.
COUGHLAN, SEMMER & LIPMAN
501 West Broadway, Suite 400
San Diego, CA 92101

Peter J. McKenna, Esq.
Eric Sarner, Esq.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
919 Third Avenue
New York, NY 10022

UNITED STATES TOBACCO COMPANY
Alan D. Hamilton, Esq.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
Four Embarcadero Center, Ste. 3800
San Francisco, CA 94111

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR PLAINTIFFS

CITY OF SAN FRANCISCO
Richard M. Heimann, Esq.
Elizabeth J. Cabraser, Esq.
LIEFF, CABRASER, HEIMANN & BERNSTEIN
275 Battery Street, 30th Floor
San Francisco, CA 94111-3339

Owen J. Clements
Chief of Special Litigation
CITY AND COUNTY OF SAN FRANCISCO
1390 Market Street, Sixth Floor
San Francisco, CA 94102

James K. Hahn, City Attorney
Donald J. Kass, Esq.
CITY OF LOS ANGELES
1600 City Hall East
200 North Main Street
Los Angeles, CA 90012

Joan R. Gallo, Esq.
Ralph C. Green, Esq.
Office of the City Attorney
CITY OF SAN JOSE
151 West Mission Street
San Jose, CA 95110

Kelvin H. Booty, Jr., County Counsel
Lorenzo E. Chambliss, Esq.
COUNTY OF ALAMEDA
1221 Oak Street, Suite 463
Oakland, CA 94612

Adrienne Grover, County Counsel
COUNTY OF MONTEREY
60 West Market Street Ste 140
Salinas, CA 93901

Victor J. Westman, County Counsel
Vickie Dawes, Esq.
COUNTY OF CONTRA COSTA
651 Pine Street, 9th Floor
Martinez, CA 94553

Thomas G. Hendricks, County Counsel
Mari-ann G. Rivers, Esq.
COUNTY OF MARIN
Room 342, Civic Center
San Rafael, CA 94930

William C. Katzenstein, County Counsel
Robert M. Pepper, Jr., Esq.
COUNTY OF RIVERSIDE
3535 10th Street
Riverside, CA 92501

Robert A. Ryan, Jr., County Counsel
COUNTY OF SACRAMENTO
700 H Street, Suite 2650
Sacramento, CA 95814

Thomas F. Casey, III, County Counsel
Brenda B. Carlson, Esq.
COUNTY OF SAN MATEO
401 Marshall Street
Redwood City, CA 94063

Steven M. Woodside, County Counsel
Ann M. Ravel, Esq.
COUNTY OF SANTA CLARA
70 West Hedding Street, 9th Floor East
San Jose, CA 95110

Karen Keating Jahr, County Counsel
COUNTY OF SHASTA
1815 Yuba Street, Suite 3
Redding, CA 96001

CITY OF SAN FRANCISCO
Alan K. Marks, County Counsel
Charles J. Larkin, Esq.
COUNTY OF SAN BERNARDINO
385 North Arrowhead Avenue, 4th Floor
San Bernardino, CA 92415

John Sansome, Esq.
Ellen Pilsecker, Esq.
COUNTY OF SAN DIEGO
1600 Pacific Coast Hwy, Room 355
San Diego, CA 92101

Stephen Shane Stark, County Counsel
Jerry F. Czuleger, Esq.
COUNTY OF SANTA BARBARA
105 East Anapamu, Suite 201
Santa Barbara, CA 93101

Dwight L. Herr, County Counsel
Rahn Garcia, Esq.
COUNTY OF SANTA CRUZ
701 Ocean Street, Room 505
Santa Cruz, CA 95060

James L. McBride, County Counsel
Noel E. Klebaum, Esq.
COUNTY OF VENTURA
800 South Victoria Avenue
Ventura, CA 93009

CORDOVA
William S. Lerach, Esq.
Patrick J. Couglin, Esq.
MILBERG, WEISS, BERSHAD, HYNES & LERACH, LLP
600 West Broadway, Suite 1800
San Diego, CA 92101

Alan M. Caplan, Esq.
Philip Neumark, Esq.
April M. Strauss, Esq.
BUSHNELL, CAPLAN & FIELDING
221 Pine Street, Suite 600
San Francisco, CA 94104-2715

Mark P. Robinson, Esq.
Kevin F. Calcagnie, Esq.
ROBINSON, CALCAGNIE & ROBINSON
1620 Newport Center Drive, Suite 700
Newport Beach, CA 92660

COUNTY OF LOS ANGELES; DAVIS/ELLIS
Browne Greene, Esq.
Bruce Broillet, Esq.
John Taylor, Esq.
Timothy Wheeler, Esq.
Brian Panish, Esq.
GREENE, BROILLET, TAYLOR, WHEELER & PANISH
100 Wilshire Boulevard, 21st Floor
Santa Monica, CA 90401

DeWitt W. Clinton, County Counsel
Roberta M. Fesler, Esq.
Steve Carnevale, Esq.
COUNTY OF LOS ANGELES
648 Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

COUNTY OF LOS ANGELES
Ronald L. Motley, Esq.
J. Anderson Berly, III, Esq.
NESS, MOTLEY, LOADHOLD, RICHARDSON & POOLE, P.A.
151 Meeting Street, Suite 600
Charleston, S.C. 29409

COUNTY OF LOS ANGELES; DAVIS/ELLIS

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General
CORINNE MURPHY
Deputy Attorney General
State Bar No.
1300 I Street
P.O. Box 944255
Sacramento, CA 94244-2550
Telephone: (916) 324-5346
Fax: (916) 323-0813
Attorneys for Plaintiffs

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN DIEGO

CENTRAL

PEOPLE OF THE STATE OF CALIFORNIA ex rel. DANIEL E. LUNGREN, ATTORNEY GENERAL OF THE STATE OF CALIFORNIA; S. KIMBERLY BELSHÉ, DIRECTOR OF HEALTH SERVICES OF THE STATE OF CALIFORNIA,

Plaintiffs,

v.

PHILIP MORRIS, INC.; R.J. REYNOLDS TOBACCO COMPANY; BROWN & WILLIAMSON TOBACCO CORPORATION; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY; LORILLARD TOBACCO COMPANY, INC.; AMERICAN TOBACCO COMPANY, INC.; UNITED STATES TOBACCO COMPANY; HILL & KNOWLTON, INC.; THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC.; TOBACCO INSTITUTE, INC.; SMOKELESS TOBACCO COUNCIL, INC. and DOES 1-200, inclusive,

Defendants.

J.C.C.P. 4041

(Sacramento Superior Court Case No: 97AS03031)

AMENDED NOTICE OF MOTION AND MOTION FOR APPROVAL OF AMENDMENT TO THE AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING APPLICABLE ONLY TO THE STATE OF CALIFORNIA AND EACH ELIGIBLE CITY OR COUNTY THAT EXECUTES THE SAME; MEMORANDUM OF POINTS AND AUTHORITIES

Date: June 4, 2001
Time: 3:00 p.m.
Dept: 69
Judge: Ronald S. Prager

PLEASE TAKE NOTICE that on June 4, 2001, at 3:00 p.m., the Honorable Ronald S. Prager, will issue a telephonic ruling on the joint motion of the People of the State of California and the Counties of Sacramento and San Diego for an order approving the "Amendment to Agreement Regarding Interpretation of Memorandum of Understanding Affecting Only the State of California and Each Eligible City and Eligible County Which Is a Signatory Hereto," (Exhibit A), which is necessary to facilitate the Securitization Transactions contemplated by certain Eligible Cities and/or Counties.

Plaintiff's motion will be based on this Amended Notice of Motion, Memorandum of Points and Authorities, and all papers, pleadings and records on file in this action and on such other and further argument and evidence as may be presented.

///

///

///

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-3331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: _____, 2001

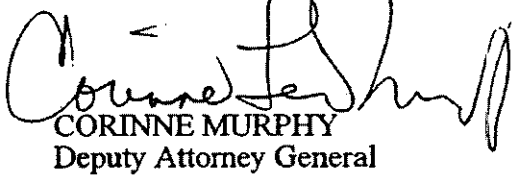
Respectfully submitted,

BILL LOCKYER

Attorney General of the State of California

RICHARD M. FRANK
Chief Assistant Attorney General

DENNIS ECKHART
Senior Assistant Attorney General



CORINNE MURPHY
Deputy Attorney General

Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO

ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO

JOHN J. SANSOME
County Counsel

WILLIAM SMITH
Deputy County Counsel

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-3331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General

CORINNE MURPHY
Deputy Attorney General
Attorneys for Plaintiffs

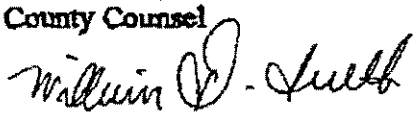
and

COUNTY OF SACRAMENTO
ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO
JOHN J. SANSOME
County Counsel



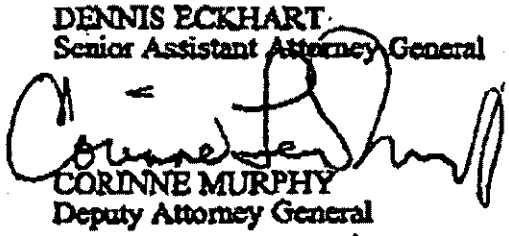
WILLIAM SMITH
Deputy County Counsel

Defendants may obtain a date for oral argument by calling the Tobacco Litigation Calendar Clerk at (619) 531-3331 by 4:00 p.m. on Friday of the same week as the telephonic ruling.

Dated: _____, 2001

Respectfully submitted,

BILL LOCKYER
Attorney General of the State of California
RICHARD M. FRANK
Chief Assistant Attorney General
DENNIS ECKHART
Senior Assistant Attorney General



CORINNE MURPHY
Deputy Attorney General
Attorneys for Plaintiffs

and

COUNTY OF SACRAMENTO
ROBERT A. RYAN, JR.
County Counsel

M. HOLLY GILCHRIST
Deputy County Counsel

and

COUNTY OF SAN DIEGO
JOHN J. SANSOME
County Counsel

WILLIAM SMITH
Deputy County Counsel

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: **People of the State of California v. Philip Morris** No.: **J.C.C.P. 4041**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service that same day in the ordinary course of business.

On May 2, 2001, I served the attached **AMENDED NOTICE OF MOTION AND MOTION FOR APPROVAL OF AMENDMENT TO THE AGREEMENT REGARDING INTERPRETATION OF MEMORANDUM OF UNDERSTANDING APPLICABLE ONLY TO THE STATE OF CALIFORNIA AND EACH ELIGIBLE CITY OR COUNTY THAT EXECUTES THE SAME; MEMORANDUM OF POINTS AND AUTHORITIES; AND (PROPOSED) ORDER APPROVING AMENDMENT TO AGREEMENT REGARDING INTERPRETATION OF MOU** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the internal mail collection system at the Office of the Attorney General at 1300 I Street, P.O. Box 944255, Sacramento, California 94244-2550, addressed as follows:

See Attached Service List

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on May 2, 2001, at Sacramento, California.

Christina Micherone
Declarant

Signature

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

AMERICAN TOBACCO CO.
Robert G. Steiner, Esq.
Christopher J. Healey, Esq.
LUCE, FORWARD, HAMILTON & SCRIPPS
600 West Broadway, Suite 2600
San Diego, CA 92101-3391

Mary T. Yelenick, Esq.
CHADBOURNE & PARKE
30 Rockefeller Plaza
New York, NY 10112

F. John Nyhan, Esq.
CHADBOURNE & PARKE
601 South Figueroa Street, Suite 1600
Los Angeles, CA 90017

B.A.T INDUSTRIES P.L.C.
Barry W. Lee, Esq.
Robert B. Mison, Esq.
STEEFEL, LEVITT & WEISS
One Embarcadero Center, 30th Floor
San Francisco, CA 94111

Jayma M. Meyer
Mark G. Cunha, Esq.
Demetra Frawketm Esq.
Marc Merriweather, Esq.
SIMPSON, THACHER & BARTLETT
425 Lexington Avenue
New York, NY 10017-3909

BROWN & WILLIAMSON TOBACCO
AMERICAN TOBACCO COMPANY
Anthony R. Delling, Esq.
PILLSBURY, MADISON & SUTRO, LLP
725 S. Figueroa Street, Ste. 1200
Los Angeles, CA 90017

BROWN & WILLIAMSON TOBACCO
Kevin J. Dunne, Esq.
Fred Baker, Esq.
SEDGWICK, DETERT, MORAN & ARNOLD
One Embarcadero Center, 16th Floor
San Francisco, CA 94111-3765

Tony L. Richardson, Esq.
KIRKLAND & ELLIS
300 South Grand Avenue, Suite 3000
Los Angeles, CA 90071

Michael J. Weaver, Esq.
Timothy B. Taylor, Esq.
Carrier Battilega, Esq.
SHEPPARD, MULLIN, RICHTER & HAMPTON
501 West Broadway, 19th Floor
San Diego, CA 92101-3035

Bradley E. Lerman, Esq.
Bart Huff, Esq.
KIRKLAND & ELLIS
200 East Randolph Drive
Chicago, IL 60601

COUNCIL FOR TOBACCO RESEARCH – U.S.A., INC.
LIGGETT GROUP, INC.
Daniel G. Murphy, Esq.
LOEB & LOEB
1000 Wilshire Blvd., #1800
Los Angeles, CA 90017-2475

COUNCIL FOR TOBACCO RESEARCH – U.S.A., INC.
Bruce Merritt, Esq.
DEBEVOISE & PLIMPTON
875 Third Avenue
New York, NY 10022

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

HILL & KNOWLTON, INC.
Meryl L. Young, Esq.
GIBSON, DUNN & CRUTCHER
401 West A Street, Suite 1900
San Diego, CA 92101

Stan G. Roman, Esq.
KRIEG KELLER SLOAN REILLEY & ROMAN
114 Sansome Street 7th Floor
San Francisco, CA 94104

Michael C. Lasky, Esq.
Bruce Ginsberg, Esq.
DAVIS & GILBERT
1740 Broadway
New York, NY 10019

LIGGETT GROUP, INC.
James J. Stricker, Esq.
Aaron H. Marks, Esq.
KASOWITZ, BENSON, TORRES & FRIEDMAN
1301 Avenue of Americas
New York, NY 10019

Jeffrey P. Lendrum, Esq.
THE LENDRUM LAW FIRM
550 West C Street, Suite 1360
San Diego, CA 92101

LORILLARD TOBACCO COMPANY
Larry E. Hays, Esq.
FENTON & KELLER
2801 Monterey Salinas Highway
Monterey, CA 93940

LORILLARD TOBACCO COMPANY
H. Christian L'Orange, Esq.
ALLEN MATKINS LECK GAMBLE & MALLORY
333 Bush Street, 17th Floor
San Francisco, CA 94104

Bruce R. Tepikian, Esq.
John C. Monica, Esq.
Craig E. Proctor, Esq.
SHOOK, HARDY & BACON, LLP
One Market
Steuart Tower, Ninth Floor
San Francisco, CA 94105

Sterling Hutcheson, Esq.
William S. Boggs, Esq.
Brian Foster, Esq.
GRAY, CARY, WARE & FREIDENRICH
401 B Street, Suite 1700
San Diego, CA 92101-4219

PHILIP MORRIS, INC.
James F. Speyer, Esq.
Maurice A. Leiter, Esq.
John D. Lombardo, Esq.
ARNOLD & PORTER
777 S. Figueroa Street, 44th Floor
Los Angeles, CA 90071-5844

Joseph S. Genshlea, Esq.
WEINTRAUB, GENSHLEA & SPROUL
400 Capitol Mall, 11th Floor
Sacramento, CA 95814

Gerald L. McMahon, Esq.
Joyce McCoy, Esq.
SELTZER, CAPLAN, WILKINS & McMAHON
750 B Street, Suite 2100
San Diego, CA 92101

PHILIP MORRIS, INC.
Curtis M. Caton, Esq.
Barry S. Levin, Esq.
HELLER, EHRMAN, WHITE & McAULIFFE
333 Bush Street, Suite 3100
San Francisco, CA 94104-2878

R.J. REYNOLDS TOBACCO CO.
H. Joseph Escher III, Esq.

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR DEFENDANTS

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN
Three Embarcadero Center, 7th Floor
San Francisco, CA 94111-4065

Robert McDermott, Jr., Esq.
Barbara McDowell, Esq.
JONES, DAY, REAVIS & POGUE
51 Louisiana Avenue NW
Washington, D.C. 20001

Robert C. Weber, Esq.
William T. Plesec, Esq.
JONES, DAY, REAVIS & POGUE
North Point
901 Lakeside Avenue
Cleveland, OH 44114

Robert C. Wright, Esq.
Joseph T. Ergastolo, Esq.
WRIGHT & L'ESTRANGE
Imperial Bank Tower
701 B Street, Suite 1500
San Diego, CA 92101

SMOKELESS TOBACCO COUNCIL, INC.
Barry S. Schaevitz, Esq.
JACOB, MEDINGER & FINNEGAN, LLP
Rockefeller Center
1270 Avenue of the Americas
New York, NY 10020

SMOKELESS TOBACCO COUNCIL, INC.
Malcolm S. Segal, Esq.
SEGAL & KIRBY
770 L Street, Ste. 1440
Sacramento, CA 95814

TOBACCO INSTITUTE, INC.
Howard A. Janssen, Esq.
Mary C. Oppedahl, Esq.

CROSBY, HEAFEY, ROACH & MAY
1999 Harrison Street
Oakland, CA 94612-3517

John Vanderstar, Esq.
Patrick Davies, Esq.
R. Laird Hart, Esq.
COVINGTON & BURLING
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2401

UNITED STATES TOBACCO COMPANY
R.J. Couglan, Jr., Esq.
Michael L. Lipman, Esq.
Duane Tyler, Esq.
COUGHLAN, SEMMER & LIPMAN
501 West Broadway, Suite 400
San Diego, CA 92101

Peter J. McKenna, Esq.
Eric Sarner, Esq.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
919 Third Avenue
New York, NY 10022

UNITED STATES TOBACCO COMPANY
Alan D. Hamilton, Esq.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
Four Embarcadero Center, Ste. 3800
San Francisco, CA 94111

SERVICE LISTING FOR JUDICIAL COUNCIL NO. 4041

COUNSEL FOR PLAINTIFFS

CITY OF SAN FRANCISCO
Richard M. Heimann, Esq.
Elizabeth J. Cabraser, Esq.
LIEFF, CABRASER, HEIMANN & BERNSTEIN
275 Battery Street, 30th Floor
San Francisco, CA 94111-3339

Owen J. Clements
Chief of Special Litigation
CITY AND COUNTY OF SAN FRANCISCO
1390 Market Street, Sixth Floor
San Francisco, CA 94102

James K. Hahn, City Attorney
Donald J. Kass, Esq.
CITY OF LOS ANGELES
1600 City Hall East
200 North Main Street
Los Angeles, CA 90012

Joan R. Gallo, Esq.
Ralph C. Green, Esq.
Office of the City Attorney
CITY OF SAN JOSE
151 West Mission Street
San Jose, CA 95110

Kelvin H. Booty, Jr., County Counsel
Lorenzo E. Chambliss, Esq.
COUNTY OF ALAMEDA
1221 Oak Street, Suite 463
Oakland, CA 94612

Adrienne Grover, County Counsel
COUNTY OF MONTEREY
60 West Market Street Ste 140
Salinas, CA 93901

Victor J. Westman, County Counsel
Vickie Dawes, Esq.
COUNTY OF CONTRA COSTA
651 Pine Street, 9th Floor
Martinez, CA 94553

Thomas G. Hendricks, County Counsel
Mari-ann G. Rivers, Esq.
COUNTY OF MARIN
Room 342, Civic Center
San Rafael, CA 94930

William C. Katzenstein, County Counsel
Robert M. Pepper, Jr., Esq.
COUNTY OF RIVERSIDE
3535 10th Street
Riverside, CA 92501

Robert A. Ryan, Jr., County Counsel
COUNTY OF SACRAMENTO
700 H Street, Suite 2650
Sacramento, CA 95814

Thomas F. Casey, III, County Counsel
Brenda B. Carlson, Esq.
COUNTY OF SAN MATEO
401 Marshall Street
Redwood City, CA 94063

Steven M. Woodside, County Counsel
Ann M. Ravel, Esq.
COUNTY OF SANTA CLARA
70 West Hedding Street, 9th Floor East
San Jose, CA 95110

Karen Keating Jahr, County Counsel
COUNTY OF SHASTA
1815 Yuba Street, Suite 3
Redding, CA 96001

CITY OF SAN FRANCISCO
Alan K. Marks, County Counsel
Charles J. Larkin, Esq.
COUNTY OF SAN BERNARDINO
385 North Arrowhead Avenue, 4th Floor
San Bernardino, CA 92415

John Sansome, Esq.
Ellen Pilsecker, Esq.
COUNTY OF SAN DIEGO
1600 Pacific Coast Hwy, Room 355
San Diego, CA 92101

Stephen Shane Stark, County Counsel
Jerry F. Czuleger, Esq.
COUNTY OF SANTA BARBARA
105 East Anapamu, Suite 201
Santa Barbara, CA 93101

Dwight L. Herr, County Counsel
Rahn Garcia, Esq.
COUNTY OF SANTA CRUZ
701 Ocean Street, Room 505
Santa Cruz, CA 95060

James L. McBride, County Counsel
Noel E. Klebaum, Esq.
COUNTY OF VENTURA
800 South Victoria Avenue
Ventura, CA 93009

CORDOVA
William S. Lerach, Esq.
Patrick J. Couglin, Esq.
MILBERG, WEISS, BERSHAD, HYNES & LERACH, LLP
600 West Broadway, Suite 1800
San Diego, CA 92101

Alan M. Caplan, Esq.
Philip Neumark, Esq.
April M. Strauss, Esq.
BUSHNELL, CAPLAN & FIELDING
221 Pine Street, Suite 600
San Francisco, CA 94104-2715

Mark P. Robinson, Esq.
Kevin F. Calcagnie, Esq.
ROBINSON, CALCAGNIE & ROBINSON
1620 Newport Center Drive, Suite 700
Newport Beach, CA 92660

COUNTY OF LOS ANGELES; DAVIS/ELLIS
Browne Greene, Esq.
Bruce Broillet, Esq.
John Taylor, Esq.
Timothy Wheeler, Esq.
Brian Panish, Esq.
GREENE, BROILLET, TAYLOR, WHEELER & PANISH
100 Wilshire Boulevard, 21st Floor
Santa Monica, CA 90401

DeWitt W. Clinton, County Counsel
Roberta M. Fesler, Esq.
Steve Carnevale, Esq.
COUNTY OF LOS ANGELES
648 Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

COUNTY OF LOS ANGELES
Ronald L. Motley, Esq.
J. Anderson Berly, III, Esq.
NESS, MOTLEY, LOADHOLD, RICHARDSON & POOLE, P.A.
151 Meeting Street, Suite 600
Charleston, S.C. 29409

COUNTY OF LOS ANGELES; DAVIS/ELLIS

(THIS PAGE INTENTIONALLY LEFT BLANK)

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

PEOPLE OF THE STATE OF CALIFORNIA ex rel. DANIEL E. LUNGREN, ATTORNEY GENERAL OF THE STATE OF CALIFORNIA; S. KIMBERLY BELSHE, DIRECTOR OF HEALTH SERVICES OF THE STATE OF CALIFORNIA, Plaintiffs, v. PHILIP MORRIS, INC.; R.J. REYNOLDS TOBACCO COMPANY; BROWN & WILLIAMSON TOBACCO CORPORATION; B.A.T INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY; LORILLARD TOBACCO COMPANY, INC.; AMERICAN TOBACCO COMPANY, INC.; UNITED STATES TOBACCO COMPANY; HILL & KNOWLTON, INC.; THE COUNCIL FOR TOBACCO RESEARCH-U.S.A.,INC.; TOBACCO INSTITUTE, INC.; SMOKELESS TOBACCO COUNCIL, INC. and DOES 1-200, inclusive, Defendants.	**Case No. J.C.C.P. 4041** (Sacramento Superior Court Case No. 97AS03031) **CONSENT DECREE and FINAL JUDGMENT**

WHEREAS, Plaintiffs, the People of the State of California and S. Kimberly Belshe, Director of Health Services of the State of California commenced this action on June 12, 1997, by and through their attorney, Attorney General Daniel E. Lungren, pursuant to his common law powers and the provisions of state law;

WHEREAS, Plaintiffs filed their First Amended Complaint on August 29, 1997;

WHEREAS, the State of California asserted various claims for monetary, equitable and injunctive relief on behalf of the State of California against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's Complaint and First 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;

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 San Diego County.

II. DEFINITIONS

The definitions set forth in the Master Settlement Agreement (hereafter referred to as "Agreement" or "MSA;" a copy of which is attached hereto as Exhibit A) are incorporated herein by reference and words defined therein are signified herein by being capitalized.

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 California or a

Released Party. The State of California 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 California 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 California.

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of California 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 California 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 California, 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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 California 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. The Memorandum of Understanding ("MOU"; a copy of which is attached hereto as Exhibit B and incorporated herein by this reference as though set forth in full) which was entered into on or about August 5, 1998, by counsel for the various plaintiffs in the cases coordinated in J.C.C.P. 4041, and which provides for the establishment of an escrow account from which California Cities and Counties may, pursuant to the MOU, receive payment, is approved in all respects.

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 also finds that the persons signing the Stipulation for Entry of Consent Decree and Final Judgment have full and complete authority to enter into said Stipulation. The Court further finds that entering into this settlement is in the best interests of the State of California.

C. The First Amended Complaint on file herein against Does 2-200, is ordered dismissed.

D. The Court Clerk is ordered to enter this Consent Decree and Final Judgment forthwith.

Dated: December , 1998

_____

RONALD S. PRAGER
JUDGE OF THE SUPERIOR COURT

(THIS PAGE INTENTIONALLY LEFT BLANK)

ESCROW AGREEMENT

between

The State of California, Depositor

and

CITIBANK, N.A., Escrow Agent

Dated as of April 12, 2000

This Escrow Agreement (the "Agreement" or the "Escrow Agreement") is entered into as of April 12, 2000 by the Attorney General of the State of California, on behalf of the State of California (the "Depositor" or the "State") and Citibank, N.A., as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the State and a number of California Cities and Counties, on August 5, 1998, entered into an agreement entitled "Memorandum of Understanding" (the "MOU"); and

WHEREAS, on December 9, 1998, the Honorable Ronald Prager, Judge of the San Diego County Superior Court, as the Coordination Trial Judge in *In re Tobacco Cases I*, J.C.C.P. 4041, signed and entered a Consent Decree and Final Judgment as between the State of California and the Participating Manufacturers, which Final Judgment incorporated within it as Exhibit A thereto the settlement agreement entitled "Master Settlement Agreement" (the "MSA") which the Settling States, including the State of California, and the Participating Manufacturers entered into, and incorporates within it as Exhibit B thereto the MOU; and

WHEREAS, pursuant to the MSA, the State is entitled to funds distributed through the National Escrow Agreement which was entered into on December 23, 1998, between the Settling States, including the State of California, and the Participating Manufacturers and the Escrow Agent; and

WHEREAS, pursuant to the National Escrow Agreement, Citibank, N.A., was appointed by the Settling States, including the State of California, and the Participating Manufacturers to serve as the Escrow Agent under the terms and conditions set forth therein; and

WHEREAS, pursuant to the National Escrow Agreement, the Escrow Agent shall allocate the national tobacco settlement monies among accounts including State-Specific Accounts with respect to each Settling State, including the State of California, in which State-Specific Finality occurs, in accordance with written instructions from the National Independent Auditor, (the "Independent Auditor"); and

WHEREAS, pursuant to the MSA, upon the occurrence of State-Specific Finality in California, the California portion of the monies deposited by the Participating Manufacturers in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, and the Subsection IX(c)(2) Account (as such accounts are defined in the National Escrow Agreement) shall be transferred to a State-Specific Account designated by the MSA as the account for the State of California ("California Account"); and

WHEREAS, pursuant to the MSA, after Final Approval, the Independent Auditor shall instruct the Escrow Agent to disburse the funds held in the California Account to (or as directed by) the State; and

WHEREAS, pursuant to the MSA, to the extent that a payment is made to the California Account after the occurrence of all applicable conditions for the disbursement of such payment to the State, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit; and

WHEREAS, pursuant to the MOU, certain Cities and all Counties in California, upon meeting the conditions set forth in the MOU, are entitled to 50% of all funds transferred to the California Account, designated as the State-Specific account for the State of California distributed by virtue of the MSA; and

WHEREAS, the State of California entered into an Agreement Regarding Interpretation of MOU (the "ARIMOU") with certain Cities and all Counties in California which requires the State of California to enter into this Escrow Agreement; and

WHEREAS, the ARIMOU requires that 50% of the money disbursed from the California account be credited to the State of California and that those certain Cities and all Counties, upon attaining eligibility by meeting the conditions set forth in the MOU and the ARIMOU, are collectively entitled to 50% of all funds distributed by virtue of the MSA and disbursed from the California Account (State-Specific account for the State of California), unless the Escrow Agent receives different instructions from the State; and

WHEREAS, the Superior Court of the County of San Diego approved the ARIMOU by Order entered on January 18, 2000;

NOW, THEREFORE, the parties agree as follows:

SECTION 1. *Appointment of Escrow Agent*

The State of California hereby appoints Citibank, N.A. to serve as Escrow Agent under this Escrow Agreement according to 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 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*

1. Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the MSA and/or the MOU and the ARIMOU.

2. "California Local Government Escrow Account" means a single, segregated account to be established by the Escrow Agent into which shall be transferred, consistent with instructions from the State, the MOU Proportional Allocable Share of each City and/or County from the funds disbursed from the California Account.

3. "City" or "Cities" means, individually or collectively, the City of Los Angeles, the City of San Diego, the City of San Francisco and the City of San Jose.

4. "City/County Account"means a single, segregated account to be established by the Escrow Agent into which shall be transferred the MOU Proportional Allocable Share of each City and/or County which has not been identified as an Eligible City or County by the State or each City and/or County about which the status as an Eligible City or County is in dispute as so identified in instructions from the State.

5. The term "City/County Steering Committee" means the City and County of San Francisco, the City of Los Angeles, the City of San Jose, the County of Santa Clara, the County of Santa Barbara and the County of Los Angeles.

6. "Claim Over" means a circumstance in which Section XII(a)(4)(A) of the MSA does not relieve an Original Participating Manufacturer of all liability and Section XII(a)(4)(B) of the MSA is invoked resulting in an Original Participating Manufacturer receiving 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 any Original Participating Manufacturer) on any liability against such Original Participating Manufacturer's share, determined as described in step E of Section IX(j)(7)(E) of the MSA, owing to the State (and by virtue of the MOU, to the Cities and Counties), 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 ("Claim Over Offset Amount").

7. "County" or "Counties" means, individually or collectively, the 58 counties of California.

8. "Disputed Claims Account" means a single, segregated account to be established by the Escrow Agent, after being instructed in writing to do so by the State, to hold disputed amounts in the event that there is a dispute as to whether the State has identified the appropriate Claim Over Offset Amount or the correct Responsible Party in the event of a Claim Over. Such disputed amounts shall be held pending subsequent written notification by the State which directs the manner of disposition to be made of the disputed amount.

9. "Eligible City," "Eligible County," "Eligible Cities and/or Eligible Counties" and/or "Eligible Cities/Eligible Counties" mean, individually or collectively, those Cities and Counties who because they have satisfied all requirements under the MOU and the ARIMOU are entitled to receive a portion of tobacco settlement monies which are transferred to the California Account as provided by the MSA, the MOU and the ARIMOU. Eligible Cities and/or Eligible Counties will be identified by the State to the Escrow Agent for the purpose of this Escrow Agreement in Attachment B hereto.

10. "Escrow Court" means the court of the State of New York to which the Escrow Agreement is presented for approval, or such other court as agreed to by the Escrow Agent and the State of California.

11. "J.C.C.P. 4041 Court" means the San Diego County Superior Court that presided over *In Re Tobacco Cases I*, Judicial Council Coordination Proceeding No. 4041.

12. "MOU Proportional Allocable Share" means that portion of the Tobacco Settlement Proceeds transferred to the California Account as provided for by the MSA and then received by the State and Cities and Counties, in the percentages set forth in Section 6 of the MOU.

13. "Responsible Entity" means the entity, whether the State or a City or County, that obtains a judgment or settlement which causes a claim-over as described in Section XII(a)(4) of the MSA. The State will advise the Escrow Agent in writing as to the identity of a Responsible Party.

14. "State" means the State of California but whenever this Escrow Agreement indicates that an action is to be taken by the State, "State" shall specifically mean the Attorney General of the State of California or a designee specified by the Attorney General in writing.

15. "State Escrow Account" means a single, segregated account to be established by the Escrow Agent into which shall be transferred, consistent with instructions from the State, the MOU Proportional Allocable Share of the State of California from the funds disbursed from the California Account.

SECTION 3. *Escrow and Accounts*

Depositor and Escrow Agent hereby agree that, in consideration of the mutual promises and covenants contained herein, Escrow Agent shall hold in escrow and shall distribute Escrow Property (as defined herein) in accordance with and subject to the following Instructions and Terms and Conditions:

INSTRUCTIONS:

1. Escrow Property

The property and/or funds deposited or to be deposited with Escrow Agent in the California Account as instructed by the Independent Auditor in accordance with the MSA.

All funds received by the Escrow Agent pursuant to the terms of this Escrow 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 Escrow Agent shall allocate the funds received by it from the California Account among the accounts referenced in this Escrow agreement (each one an "Account" and collectively the "Accounts") including the State Escrow Account, California Local Government Escrow Account, the City/County Account and the Disputed Claims Account in accordance with written instructions from the State.

The foregoing property and/or funds, plus all interest, dividends and other distributions and payments thereon (collectively the "Distributions") received by the Escrow Agent, less any property and/or funds distributed or paid in accordance with this Escrow Agreement, are collectively referred to herein as "Escrow Property." The Escrow Agent shall have no duty to solicit the Escrow Property.

2. Investment of Escrow Property

The Escrow Agent shall invest or reinvest Escrow Property, without distinction between principal and income, in accordance with written instructions delivered to the Escrow Agent by the State specifying any one or more of the following investments from the Depositor designated herein.

A. Direct obligations of, or obligations the timely payment of principal and interest on which are fully and unconditionally guaranteed by, the United States of America or any agency thereof, maturing no more than one year after the date of acquisition thereof;

B. Interest-bearing time or demand deposits with, or certificates of deposit maturing within 30 days of the acquisition thereof and issued by, any bank or trust company organized under the laws of the United States of America or of any of the 50 states thereof and having combined capital, surplus and undistributed profits in excess of $500,000,000 whose long-term unsecured debt is rated "AA" or higher by Standard & Poor's and "Aa" or higher by Moody's;

C. Commercial paper rated (on the date of acquisition thereof) at least A-1 and P-1 or equivalent by Standard & Poor's and Moody's, respectively, maturing not more than 180 days from the date of creation thereof; and

D. Other investments specified by written instructions from all of the Original Participating Manufacturers, Settling States having Allocable Shares aggregating at least 66 ⅔%, and the State.

In the absence of written instructions the Escrow Agent will invest Escrow Property in the Citibank Nassau Time-Deposit Account so long as said account meets the criteria set forth in 2.B, above.

Each reference herein to a rating from Standard & Poor's or Moody's shall be construed as an equivalent rating by another nationally recognized credit rating agency and if one (but not both) of Standard & Poor's and Moody's is not then in the business of rating debt the required rating from the corporation still in such business shall suffice for the purposes of this section 3.

The Escrow Agent shall have no obligation to invest or reinvest the Escrow Property if deposited with the Escrow Agent after 11:00 a.m. (E.S.T.) on such day of deposit. Instructions received after 11:00 a.m.(E.S.T.) will be treated as if received on the following business day.

The Escrow Agent shall have the power to sell or liquidate the foregoing investments whenever the Escrow Agent shall be required to release the Escrow Property pursuant to the terms thereof. Requests (or instructions) received after 11:00 a.m. (E.S.T.) by the Escrow Agent to liquidate the Escrow Property will be treated as if received on the following business day. The Escrow Agent shall have no responsibility for any investment losses resulting from the investment, reinvestment or liquidation of the Escrow Property. Any interest or other income received on such investment and reinvestment of the Escrow Property shall become part of the Escrow Property. If a selection is not made, the Escrow Property shall remain

uninvested with no liability for interest therein. It is agreed and understood that the Escrow Agent may earn fees associated with the investments outlined above.

The Escrow Agent shall have no liability for any loss arising from or related to any such investment other than in accordance with paragraph 5 of the Terms and Conditions.

5. Distribution of Escrow Property

A. The Escrow Agent is directed to hold and distribute the Escrow Property in the amounts as are calculated and specified in writing by the State and in the following manner:

(1) 50% of each dollar, or portion thereof, distributed from the California Account shall be credited to the State and placed in the State Escrow Account; and

(2) 50% of each dollar, or portion thereof, shall be credited to the Cities and Counties and placed in the California Local Government Escrow Account.

B. Immediately upon receipt, each dollar, or portion thereof, credited to the State Escrow Account shall be distributed in the manner set forth in Attachment A unless the Escrow Agent receives different instructions in writing from the State three business days prior to deposit.

C. Immediately upon receipt, each dollar, or portion thereof, credited to the California Local Government Account shall be distributed in the manner set forth below as such amounts are calculated and specified in writing by the State unless the Escrow Agent receives different instructions in writing from the State three business days prior to deposit.

Ten percent (10%) of the funds is to be credited to the Cities. Each Eligible City shall be allocated two and one half percent (2.5%). The remaining ninety percent (90%) of the funds to be credited to the Cities and Counties shall be allocated among the Eligible Counties, on a per capita basis, calculated by using population data set forth for California Counties as reported in the most current Official United States Decennial Census.

The State shall make any necessary adjustments to the distribution percentages as they relate to this clause and the MOU promptly upon the issuance of each future Official United States Decennial Census. Until further notification the Eligible Cities and Counties shall receive MOU Proportional Allocable shares in the proportions set forth in Attachment B hereto.

D. On the third Business Day after a transfer into an Account, the Escrow Agent shall deliver to the State a statement showing the amount of such transfer, the source of the transfer, and the Account or Accounts to which such transfer has been credited. All amounts credited to an account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement and/or pursuant to written instructions by the State. In the event of a conflict, instructions from the State shall govern over instructions contained in this Escrow agreement. The Escrow Agent shall be entitled to conclusively rely on the instructions provided by the State.

E. Distribution shall be by wire transfer and shall be made to the State, Eligible Cities and Eligible Counties as provided in Attachments A and C hereto no later than the next Business Day after the funds have been credited to the State Escrow Account and the California Local Government Account unless contrary instructions in writing actually have been received by the Escrow Agent from the State three business days prior to distribution. It is understood by the parties to this Escrow agreement that instructions received after 11:00 a.m. (E.S.T.) will be treated as if received on the following Business Day.

F. On the third Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to the State a written statement showing the amount disbursed to each Eligible City/Eligible County or the State and the date of such transfer.

G. No funds are to be disbursed to any City or County that has not been identified by the State as an Eligible City or County. If any city or county has not attained Eligibility, the MOU Proportional Allocable Share set forth in Attachment B plus interest thereon as specified by the State in writing for each such City and/or County shall be placed in a single segregated account, the "City/County Account," established by the Escrow Agent, and held (along with any earnings thereon), separate and apart from all other funds and accounts of the Escrow Agent, until the Escrow Agent receives further written instructions from the State. The Escrow Agent shall promptly provide to the State an accounting of the funds placed in the account, indicating the total amount placed therein and the amount placed therein which is being held for the benefit of each specific City or County. The Escrow Agent may charge each such City or County whose MOU Proportional Allocable Share is placed in such account, such City's or County's proportional share of the Escrow Agent's normal charges for establishing and maintaining such account (based on the percentage that such City's or County's MOU Proportional Allocable Share represents of the total amount in such account) through the date the Escrow Agent is notified by the State that such City and/or County has obtained the status of Eligible City or Eligible County and the Escrow Agent may deduct such charges from the amount such City and/or County is due when the Escrow Agent is notified by the State that such City and/or County has obtained the status of Eligible City or Eligible County. The Escrow Agent will charge each such City or County by notifying the State in writing of its fees and expenses in connection with establishing and maintaining such account. The State will then calculate how much of such fees and expenses are allocable to each City and County, and then notify the Escrow Agent in writing of the amounts allocated to each City and County. The Escrow Agent will then deduct the specified charges from the appropriate account as directed by the State in writing.

H. When the Escrow Agent receives written notification from the State (including specific dollar amounts) that any City and/or County has attained the status of Eligible City and/or Eligible County, the Escrow Agent shall no later than one Business Day subsequent thereto disburse to such newly Eligible City and/or Eligible County all funds representing such newly Eligible City's and/or Eligible County's MOU Proportional Allocable Share which had previously been placed in the separate City/County Account pursuant to subparagraph G above including any interest generated therefrom, after deducting the appropriate Escrow Agent's charges in the specific amounts instructed in writing by the State.

I. In the event of a dispute as to whether a City and/or a County has attained the status of an Eligible City and/or Eligible County, the Escrow Agent, upon receiving written instructions from the State, shall deposit the MOU Proportional Allocable Share of any such City and/or County to which such dispute pertains into the City/County Account. The Escrow Agent shall promptly provide to the State an accounting of the funds placed in such account, indicating the total amount placed therein and the amount placed therein which is being held for the benefit of each specific City and/or County. Upon receipt from the State of an order or judgment of eligibility issued by the J.C.C.P. 4041 Court, the Escrow Agent shall disburse all funds including interest allocated to such newly Eligible City or newly Eligible County no later than one Business Day after actual receipt of such notice from the State. Escrow Agent charges may be calculated and deducted in the same manner as Subparagraph G above.

J. In the event that there is a dispute resulting from a "Claim Over," the Escrow Agent, as instructed in writing by the State, shall establish a segregated account, the "Disputed Claims Account", into which will be distributed funds in the amount that the State has identified as the Claim Over Offset Amount or such part of that amount that is the subject of dispute. Such account shall be established in the name of the Responsible Entity as identified by the State to the Escrow Agent in writing (i.e., "Disputed Claims Account of ---------). The Escrow Agent may charge each such Responsible Entity its normal charges for establishing and maintaining each such Disputed Claims Account. The Escrow Agent may, upon notice received from the State as to who is liable for the Escrow Agent's charges, deduct its charges from the

amount due the Responsible Entity, the State or those members of the City/County Steering Committee that are identified as liable.

K. If the Escrow Agent has not received written notification from the State that a City or County has attained the status of Eligible City and/or Eligible County, by the later of June 30, 2001, or the expiration of any grace period specified by the State, the Escrow Agent, upon written instruction by the State and after deducting the appropriate Escrow Agent's charges, shall do the following:

(1) All funds previously placed in the City/County account (including any proceeds generated therefrom) for such City or County shall be deducted from such account and 50% thereof shall be disbursed to the State Escrow Account and the remaining 50% shall be disbursed to the California Local Government Escrow Account for distribution consistent with subparagraphs B, C, D, E and F, above, unless contrary instructions have been provided by the State.

(2) The Escrow Agent, upon receipt of notification from the State that such City and/or County has subsequently attained the status of Eligible City and/or Eligible County, shall disburse all MOU Proportional Allocable Shares for such City and/or County which accrue after the date of notification that such City/County has obtained the status of Eligible City or Eligible County unless the State provides written instructions to the Escrow Agent that a specific lesser amount shall be paid because of a claim over.

L. In the event of a "Claim Over", it is the intent of the State and the Cities and Counties that, in accordance with the MOU, all benefits and burdens that affect the funds to be distributed to and from the California Account will be borne equally by the State on one hand, and the Eligible Cities and Eligible Counties on the other.

(1) The State shall notify the Escrow Agent, that Section XII(a)(4)(B) of the MSA has been invoked, and provide the Escrow Agent with written instructions specifying amounts (including interest) and account information, stating the Claim Over Offset Amount and the identity of the Responsible Entity and instruct the Escrow Agent as follows:

(a) That the amounts otherwise allocable to the Responsible Entity shall thereafter be reduced dollar-for-dollar until the full Claim Over Offset Amount has been deducted from the MOU Proportional Allocable Share owed to the Responsible Entity.

(b) That the Responsible Entity shall be responsible for the interest on the Claim Over Offset Amount at the annual rate equal to the available daily rate of return earned by the California Pooled Money Investment Account from the actual date of disbursal of the reduced share to the State and to the Eligible Cities and Eligible Counties. Interest owed is determined from the date the funds are released to the date of actual disbursal to the State/Eligible Cities/Eligible Counties.

(2) If the Escrow Agent is not instructed in writing that action has been taken to contest the State's identification of the correct Responsible Entity or appropriate Claim Over Offset Amount, the following shall occur in accordance with written instructions from the State specifying the amounts referenced in this section 3(L) (2) (a) as calculated by the State, and account information:

(a) If the Claim Over Offset Amount is less than the MOU Proportional Allocable Share of the Responsible Entity, the Claim Over Offset Amount shall be deducted and credited as follows:

(i) If the Responsible Entity is the State, in the manner set forth in the mathematical example attached hereto as Attachment D, to wit:

(aa) An amount equal to one-half of the offset shall be deducted from the State's Escrow Account share and shall be credited to the California Local Government Account.

(bb) Any amounts credited to the California Local Government Account pursuant to this subparagraph shall be allocated among and disbursed to the Eligible Cities and Eligible Counties as provided in Section 3 of this Escrow agreement and as instructed by the State.

(ii) If the Responsible Entity is a City or County, in the manner set forth in the mathematical example attached hereto as Attachment E, to wit:

(aa) An amount equal to one-half of the offset shall be deducted from the Responsible Entity's MOU Proportional Allocable Share and shall be credited to the State's Escrow Account.

(bb) After making the deduction described in paragraph (aa), the remaining one-half of the offset shall be deducted from the Responsible Entity's MOU Proportional Allocable Share, and shall be reallocated to each Eligible City and Eligible County (including the Responsible Entity) pursuant to its MOU Proportional Allocable Share in the manner provided in Section 3 of this Escrow agreement. The State will notify the Escrow Agent of distribution amounts to be made to the State and to each Eligible City and Eligible County.

(b) If the Claim Over Offset Amount is equal to or greater than the MOU Proportional Allocable Share of the Responsible Entity, the State shall instruct the Escrow Agent that such Claim Over Offset Amount shall be deducted and credited as follows in accordance with written instructions from the State specifying the amounts referenced in this section 3(L) (2) (a) as calculated by the State, and account information:

(i) If the Responsible Entity is the State, in the manner set forth in the mathematical example attached hereto as Attachment F, to wit:

(aa) The entire MOU Proportional Allocable Share of the State shall be credited to the California Local Government Account until the Claim Over Offset Amount has been repaid in full, including interest as described in Section L.(1)(b) of this Escrow agreement.

(bb) Once any remaining Claim Over Offset Amount, including any interest as described in Section L.(1)(c), is less than the Responsible Entity's MOU Proportional Allocable Share during any payment period, Section L.(2)(a) shall govern distribution and allocation.

(cc) Any amounts credited to the California Local Government Account pursuant to this Section L.(2)(b) shall be disbursed among the Cities and Counties as provided in Section 3 of this Escrow agreement.

(ii) If the Responsible Entity is a City or County, in the manner set forth in the mathematical example attached hereto as Attachment G, to wit:

(aa) The entire MOU Proportional Allocable Share of the Responsible Entity shall be credited 50% to the State Escrow Account

and 50% to the California Local Government Account until the Claim Over Offset Amount has been repaid in full, including interest as described in Section L.(1)(c) of this Escrow agreement. The Responsible Entity's MOU Proportional Allocable Share of any amounts redistributed to the California Local Government Account under this paragraph (aa) shall be credited 50% to the State Escrow Account and 50% pro rata to the remaining Cities and Counties (excluding the Responsible Entity) based on their MOU Proportional Allocable Shares.

(bb) At such time as any remaining Claim Over Offset Amount, including any interest as described in Section L.(1)(c), is less than the Responsible Entity's MOU Proportional Allocable Share during any payment period then Section L.(2)(a) shall govern distribution and allocation.

(cc) The State shall instruct the Escrow Agent as to the appropriate deductions and credits as set forth in this Section L.(2)(b).

(3) If a petition is filed with the J.C.C.P. 4041 Court for a ruling regarding a dispute over the identification of the correct Responsible Entity or the amount of claim over offset, the State shall instruct the Escrow Agent to establish a Disputed Claims Account to hold such disputed amounts pending subsequent notification by the State which directs the manner of disposition to be made of the disputed amount. The State will instruct the Escrow Agent to distribute the disputed amount in accordance with any order or judgment entered by the Court. An appeal of such decision shall not delay distribution of the disputed amounts absent a court order to the contrary from the appropriate California Court which has been provided to the Escrow Agent by the State.

(4) The Escrow Agent shall be entitled to conclusively rely upon the State's identification of the Responsible Entity and the Claim Over Offset Amount in allocating and distributing funds.

4. Addresses and Account Information

Notices, instructions and other communications shall be sent to Escrow Agent as follows: Global Agency & Trust Services Department, Citibank, N.A., 111 Wall Street, 5th Floor, New York, New York 10043, (telephone number: (212) 657-5035, facsimile number: (212) 657-3866 and to the State at the Office of the Attorney General, 1300 I Street, P.O. Box 944255, Sacramento, CA 94244-2550, telephone number: (916) 323-3770, facsimile number: (916) 323-0813 or 327-2319.

5. Distribution of Escrow Property Upon Termination

Upon termination of this Escrow Agreement, Escrow Property then held hereunder shall be distributed as set forth in Section 3, above, unless the State has provided instructions in writing to the contrary.

6. Compensation

(a) All fees and expenses due and owing the Escrow Agent shall be deducted equally, i.e. 50% from each, from the State Escrow Account and the California Local Government Escrow Account prior to the disbursement of any funds pursuant to this escrow agreement and/or transfer of any funds to

any other account, such as the City/County Account or the Disputed Claims Account. The following fees and expenses shall be paid:

(i) At the time of execution of this Escrow Agreement, an acceptance fee of $2500;

(ii) An annual flat fee of $50,000 including disbursement for the State Escrow Account and California Local Escrow Account until April 15, 2004, then, $36,000 flat annual fee including disbursement for the State Escrow Account and California Local Escrow Account beginning April 15, 2004 until termination of the escrow facility ; and

(iii) An annual flat fee of $8000 and $100 per disbursement per Disputed Claims Account; and

(iv) An annual flat fee of $8000 and $100 per disbursement upon activation of the City/County Account; and

(v) All reasonable expenses, disbursements and advances incurred or made by the Escrow Agent in performance of its duties hereunder (including reasonable fees, expenses and disbursements of its counsel).

It is understood that the Escrow Agent's fees may be adjusted from time to time to conform to its then current guidelines.

(b) Depositor shall pay an investment transaction fee of $100.00 for each purchase or sale of a security made by Escrow Agent hereunder.

(c) Depositor shall be responsible for and shall reimburse Escrow Agent upon demand for all fees, expenses and disbursements incurred or made by Escrow Agent in connection with this Escrow Agreement.

SECTION 4 *Terms and Conditions*

1. 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 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.

2. The duties, responsibilities and obligations of Escrow Agent shall be limited to those expressly set forth herein and no duties, responsibilities or obligations shall be inferred or implied. The Escrow Agent shall not be subject to, nor required to comply with, any other agreement to which Depositor is a party, even though reference thereto may be made herein, or to comply with any direction or instruction (other than those contained herein or delivered in accordance with this Escrow Agreement) from Depositor or an entity acting on its behalf. Escrow Agent shall not be required to expend or risk any of its own funds or otherwise incur any financial or other liability in the performance of any of its duties hereunder.

3. This Escrow Agreement is for the exclusive benefit of the parties hereto and their respective permitted successors hereunder, and shall not be deemed to give, either express or implied, any legal or equitable right, remedy, or claim to any other entity or person whatsoever except as provided in paragraph 14 hereof with respect to the resignation of the Escrow Agent.

4. If at any time Escrow Agent is served with any judicial or administrative order, judgment, decree, writ or other form of judicial or administrative process which in any way affects the Escrow Property (including but not limited to orders of attachment or garnishment or other forms of levies or injunctions or stays relating to the transfer of the Escrow Property), Escrow Agent is authorized to comply therewith in any manner it or legal counsel of its own choosing deems appropriate; and if Escrow Agent complies with any such judicial or administrative order, judgment, decree, writ or other form of judicial or administrative process, Escrow Agent shall not be liable to any of the parties hereto or to any other person or entity even though such order, judgment, decree, writ or process may be subsequently modified or vacated or otherwise determined to have been without legal force or effect.

5. (A) Escrow Agent shall not be liable for any action taken or omitted or for any loss or injury resulting from its actions or its performance or lack of performance of its duties hereunder in the absence of gross negligence or willful misconduct on its part. In no event shall Escrow Agent be liable (i) for acting in accordance with or relying upon any instruction, notice, demand, certificate or document from any Depositor or any entity acting on behalf of any Depositor, (ii) for any indirect, consequential, punitive or special damages, regardless of the form of action and whether or not any such damages were foreseeable or contemplated, (iii) for the acts or omissions of its nominees, correspondents, designees, agents, subagents or subcustodians, (iv) for the investment or reinvestment of any cash held by it hereunder, in each case in good faith, in accordance with the terms hereof, including without limitation any liability for any delays (not resulting from its gross negligence or willful misconduct) in the investment or reinvestment of the Escrow Property, or any loss of interest incident to any such delays, or (v) for an amount in excess of the value of the Escrow Property, valued as of the date of deposit, but only to the extent of direct money damages.

(B) If any fees, expenses or costs incurred by, or any obligations owed to, Escrow Agent or its counsel hereunder are not promptly paid when due, Escrow Agent may reimburse itself therefor from the Escrow Property and may sell, convey or otherwise dispose of any Escrow Property for such purpose. The Escrow Agent may in its sole discretion withhold from any distribution of Escrow Property an amount of Escrow Property it believes would, upon sale or liquidation, produce proceeds equal to any unpaid amounts to which Escrow Agent is entitled to hereunder.

(C) As security for the due and punctual performance of any and all of Depositor's obligations to Escrow Agent hereunder, now or hereafter arising, Depositor hereby pledges, assigns and grants to Escrow Agent a continuing security interest in, and a lien on , the Escrow Property and all Distributions thereon or additions thereto (whether such additions are the result of deposits by Depositors or the investment of Escrow Property). The security interest of Escrow Agent shall at all times be valid, perfected and enforceable by Escrow Agent against Depositor and all third parties in accordance with the terms of this Escrow Agreement.

(D) Escrow Agent may consult with legal counsel of its own choosing at the expense of the Depositor as to any matter relating to this Escrow Agreement, and Escrow Agent shall not incur any liability in acting in good faith in accordance with any advice from such counsel.

(E) Escrow Agent shall not incur any liability for not performing any act or fulfilling any duty, obligation or responsibility hereunder by reason of any occurrence beyond the control of Escrow Agent (including but not limited to any act or provision of any present or future law or regulation or governmental authority, any act of God or war, or the unavailability of the Federal Reserve Bank wire or facsimile or other wire or communication facility).

(F) The Escrow Agent shall be entitled to rely upon any order, judgment, certification, demand, notice, instrument or other writing delivered to it hereunder without being required to determine the authenticity or the correctness of any fact stated therein or the propriety or validity or the service thereof. The Escrow Agent may act in reliance upon any instrument or signature believed by it to be genuine and

may assume that any person purporting to give receipt or advice to make any statement or execute any document in connection with the provisions hereof has been duly authorized to do so.

6. Unless otherwise specifically set forth herein Escrow Agent shall proceed as soon as practicable to collect any checks or other collection items at any time deposited hereunder. Should Escrow Agent in its sole discretion or otherwise credit Distributions before the same are finally collected, such credits shall be provisional and may be reversed by Escrow Agent without notice until such time as the same shall be finally collected. All such collections shall be subject to Escrow Agent's usual collections practices or terms regarding items received by Escrow Agent for deposit or collection. Escrow Agent shall not be required, or have any duty, to notify anyone of any payment or maturity under the terms of any instrument deposited hereunder, nor to take any legal action to enforce payment of any check, note or security deposited hereunder or to exercise any right or privilege which may be afforded to the holder of any such security.

7. Escrow Agent shall provide to Depositor monthly statements identifying transactions, transfers or holdings of Escrow Property and each such statement shall be deemed to be correct and final upon receipt thereof by the Depositor unless Escrow Agent is notified in writing, by the Depositor, to the contrary within thirty (30) business days of the date of such statement.

8. Escrow Agent shall not be responsible in any respect for the form, execution, validity, value or genuineness of documents or securities deposited hereunder, or for any description therein, or for the identity, authority or rights of persons executing or delivering or purporting to execute or deliver any such document, security or endorsement. The Escrow Agent shall not be called upon to advise any party as to the wisdom in selling or retaining or taking or refraining from any action with respect to any securities or other property deposited hereunder.

9. The Escrow Agent shall not be under any duty to give the Escrowed Property held by it hereunder any greater degree of care than it gives its own similar property and shall not be required to invest any funds held hereunder except as directed in this Escrow Agreement. Uninvested funds held hereunder shall not earn or accrue interest.

10. When the Escrow Agent is instructed in writing to deliver securities against payment, or to effect payment against delivery, delivery and receipt of payment may not be completed simultaneously, and the Depositor agrees that the Escrow Agent shall incur no liability for any credit risk involved, and that the Escrow Agent may deliver and receive securities, and arrange for payments to be made and received, in accordance with customs prevailing from time to time among brokers or dealers in such securities.

11. Notices, instructions or other communications shall be in writing in English and shall be given to the address set forth in the "Addresses" provision herein (or to such other address as may be substituted therefor by written notification to Escrow Agent or Depositor). Notices to Escrow Agent shall be deemed to be given when actually received by the Escrow Agent (Global Agency Trust). Escrow Agent is authorized to comply with and rely upon any notices, instructions or other communications believed by it to have been sent or given by Depositor or by a person or persons authorized by Depositor. Whenever under the terms hereof the time for giving a notice or performing an act falls upon a Saturday, Sunday, or a banking holiday in New York, such time shall be extended to the next day on which the Escrow Agent is open for business.

12. The Depositor shall indemnify, hold harmless and defend the Escrow Agent and its officers, director, employees and agents from and against any an 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. Anything in this Escrow Agreement to the contrary notwithstanding, in no event shall the Escrow Agent be liable for special, indirect or consequential loss or damage of any kind whatsoever (including but not

limited to lost profits). In addition, when the Escrow Agent acts on any information, instructions, communications, (including, but not limited to, communications with respect to the delivery of securities or the wire transfer of funds) sent by telephone, telex or facsimile, the Escrow Agent, absent gross negligence, shall not be responsible or liable in the event such communication is not an authorized or authentic communication of the Depositor or is not in the form the Depositor sent or intended to send (whether due to fraud, distortion or otherwise). The Depositor shall indemnify the Escrow Agent against any loss, liability, claim or expense (including legal fees and expenses) it may incur with its acting in accordance with any such communication. This paragraph shall survive the termination of this Escrow Agreement or the removal of the Escrow Agent.

13. (A) Depositor may remove Escrow Agent at any time by giving to Escrow Agent thirty (30) calendar days' prior notice in writing. Escrow Agent may resign at any time by giving the Depositor thirty (30) calendar days' prior written notice thereof.

(B) Within ten (10) calendar days after giving the foregoing notice of removal to Escrow Agent or receiving the foregoing notice of resignation from Escrow Agent, the Depositor shall agree on and appoint a successor Escrow Agent, and provide written notice of such to the resigning Escrow Agent. If a successor Escrow Agent has not accepted such appointment by the end of such 10-day period, Escrow Agent may, in its sole discretion, deliver the Escrow Property to the State for deposit in the "Tobacco Settlement Account Fund" at the address provided herein or may apply to a court of competent jurisdiction for the appointment of a successor Escrow Agent or for other appropriate relief. The costs and expenses (including reasonable attorneys' fees and expenses) incurred by Escrow Agent in connection with such proceeding shall be paid by, and be deemed a joint and several obligation of, the Depositor. In the event of any such resignation or removal, the Escrow Agent shall have no further obligation with respect to the Escrow Property.

(C) Upon receipt of the identity of the successor Escrow Agent, Escrow Agent shall either deliver the Escrow Property then held hereunder to the successor Escrow Agent, less Escrow Agent's fees, costs and expenses or other obligations owed to Escrow Agent, or hold such Escrow Property (or any portion thereof), pending distribution, until all such fees, costs and conclusively expenses or other obligations are paid.

(D) Upon delivery of the Escrow Property to the successor Escrow Agent, Escrow Agent shall have no further duties, responsibilities or obligations hereunder.

14. (A) In the event of any ambiguity or uncertainty hereunder or in any notice, instruction or other communication received by Escrow Agent hereunder, Escrow Agent may, in its sole discretion, refrain from taking any action other than retain possession of the Escrow Property, unless Escrow Agent receives written instructions, which eliminates such ambiguity or uncertainty.

(B) In the event of any dispute between or conflicting claims by or among the Depositor and/or any other person or entity with respect to any Escrow Property, Escrow Agent shall be entitled, in its sole discretion, to refuse to comply with any and all claims, demands or instructions with respect to such Escrow Property so long as such dispute or conflict shall continue, and Escrow Agent shall not be or become liable in any way to the Depositor for failure or refusal to comply with such conflicting claims, demands or instructions. Escrow Agent shall be entitled to refuse to act until, in its sole discretion, either (i) such conflicting or adverse claims or demands shall have been determined by a final order, judgment or decree of a court of competent jurisdiction, which order, judgment or decree is not subject to appeal, or settled by agreement between the conflicting parties as evidenced in a writing satisfactory to Escrow Agent or (ii) Escrow Agent shall have received security or an indemnity satisfactory to it sufficient to hold it harmless from and against any and all Losses which it may incur by reason of so acting. Any court order, judgment or decree shall be accompanied by a legal opinion by counsel for the presenting party, satisfactory to the Escrow Agent, to the effect that said order, judgment or decree represents a final adjudication of the rights of the parties by a court of competent jurisdiction, and that the time for appeal

from such order, judgment or decree has expired without an appeal having been perfected. The Escrow Agent shall act on such court order and legal opinions without further question. Escrow Agent may, in addition, elect, in its sole discretion, to commence an interpleader action or seek other judicial relief or orders as it may deem, in its sole discretion, necessary. The costs and expenses (including reasonable attorneys' fees and expenses) incurred in connection with such proceeding shall be paid by, and shall be deemed a joint and several obligation of, the Depositor.

(C) The Escrow Agent shall have no responsibility for the contents of any writing of the arbitrators or any third party contemplated herein as a means to resolve disputes and may conclusively rely without any liability upon the contents thereof.

15. This Escrow Agreement shall be interpreted, construed, enforced and administered in accordance with the internal substantive laws (and not the choice of law rules) of the State of New York. The Depositor hereby submits to the personal jurisdiction of, and each agrees that all proceedings relating hereto shall be brought in, courts located within the City and State of New York Escrow Court. The Depositor hereby waives the right to trial by jury and to assert counterclaims in any such proceedings. To the extent that in any jurisdiction Depositor may be entitled to claim, for itself or its assets, immunity from suit, execution, attachment (whether before or after judgment) or other legal process, each hereby irrevocably agrees not to claim, and hereby waives, such immunity. Depositor waives personal service of process and consents to service of process by certified or registered mail, return receipt requested, directed to it at the address last specified for notices hereunder, and such service shall be deemed completed ten (10) calendar days after the same is so mailed. Any court order shall be accompanied by a legal opinion by counsel for the presenting party satisfactory to the Escrow Agent to the effect that said opinion is final and non-appealable. The Escrow Agent shall act on such court order and legal opinions without further question.

16. The Escrow Agent does not have any interest in the Escrow Property deposited hereunder but is serving as escrow holder only and having only possession thereof. The Depositor shall pay or reimburse the Escrow Agent upon request for any transfer taxes or other taxes relating to the Escrow Property incurred in connection herewith and shall indemnify and hold harmless the Escrow Agent from any amounts that it is obligated to pay in the way of such taxes. Any payments of income from the Escrow Property shall be subject to withholding regulations then in force with respect to United States taxes. The Depositor will provide the Escrow Agent with appropriate W-9 forms for tax I.D., number certifications, or W-8 forms for non-resident alien certifications. This paragraph shall survive notwithstanding any termination of this Escrow Agreement or the resignation or removal of the Escrow Agent.

18. Except as otherwise permitted herein, this Escrow Agreement may be modified only by a written amendment signed by all the parties hereto, and no waiver of any provision hereof shall be effective unless expressed in a writing signed by the party to be charged.

19. The rights and remedies conferred upon the parties hereto shall be cumulative, and the exercise or waiver of any such right or remedy shall not preclude or inhibit the exercise of any additional rights or remedies. The waiver of any right or remedy hereunder shall not preclude the subsequent exercise of such right or remedy.

20. Each Depositor hereby represents and warrants (a) that this Escrow Agreement has been duly authorized, executed and delivered on its behalf and constitutes its legal, valid and binding obligation and (b) that the execution, delivery and performance of this Escrow Agreement by the Depositor does not and will not violate any applicable law or regulation.

21. The invalidity, illegality or unenforceability of any provision of this Escrow Agreement shall in no way affect the validity, legality or enforceability of any other provision; and if any provision is held to be unenforceable as a matter of law, the other provisions shall not be affected thereby and shall remain in full force and effect.

22. This Escrow Agreement shall constitute the entire agreement of the parties with respect to the subject matter and supersedes all prior oral or written agreements in regard thereto.

23. The provisions of these Terms and Conditions and paragraph 6 of Part I shall survive termination of this Escrow Agreement and/or the resignation or removal of the Escrow Agent.

24. No printed or other material in any language, including prospectuses, notices, reports, and promotional material which mentions "Citibank, N.A." by name or the rights, powers, or duties of the Escrow Agent under this Escrow Agreement shall be issued by any other parties hereto, or on such party's behalf, without the prior written consent of Escrow Agent.

25. The headings contained in this Escrow Agreement are for convenience of reference only and shall have no effect on the interpretation or operation hereof.

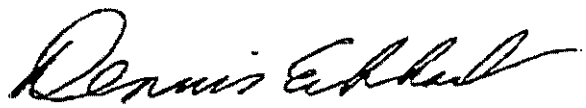
26. This Escrow Agreement may be executed by each of the parties hereto in any number of counterparts, each of which counterpart, when so executed and delivered, shall be deemed to be an original and all such counterparts shall together constitute one and the same agreement.

27. No party may assign any of its rights or obligations under this Escrow Agreement without the written consent of the other parties.

28. Any corporation into which the Escrow Agent may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Escrow Agent shall be a party, or any corporation succeeding to the business of the Escrow Agent shall be the successor of the Escrow Agent hereunder without the execution or filing of any paper with any party hereto or any further act on the part of any of the parties hereto except where an instrument of transfer or assignment is required by law to effect such succession, anything herein to the contrary notwithstanding.

IN WITNESS WHEREOF, each of the parties have caused this Escrow Agreement to be executed by a duly authorized officer as of the day and year first written above.

Depositor, State of California

By: 

Name: Dennis Eckhart
Title: Senior Assistant Attorney General

CITIBANK, N.A., as Escrow Agent

By:

Name:
Title:

ATTACHMENT A

WIRING INSTRUCTIONS INFORMATION FORM
Final Approval Disbursement

Please complete this form and fax it to Brian Wycliff at PricewaterhouseCoopers (fax no: 212-596-7969) and Mary Schlaefer at NAAG (fax no: 202-408-8064) by Monday, October 11, 1999.

State: California

Attorney General: Bill Lockyer
(signature)

Date: October 12 1999

BANK ROUTING INFORMATION

Bank Name: Bank of America, San Francisco, California

Bank ABA Routing Number: 121000358

Bank Account Number: 01482 - 80005

Bank Account Name: Department of Justice - Tobacco Litigation

Primary Bank Contact Person, Title, Telephone #, E-mail address: Marilyn Goodridge / Northern Californ Government Banking, Unit 1436/ (916) 321-4803

Secondary Bank Contact Person, Title, Telephone #: Lena Sgheiza, Northern California Government Banking, Unit 1436/ (916) 321-4808

Bank address: 555 Capitol Mall, Suite 1436, Sacramento, California 95814

Bank Telephone #: (916) 321-4803 **Bank Fax #:**(916) 321-4822

STATE GOVERNMENT CONTACT INFORMATION

Primary Contact Person, Title, Telephone #: Vicky Archer/ Treasurer's Officer/ (916) 653-3340

Address: State Treasurer's Office, 915 Capitol Mall, Room 319, Sacramento, California 95814

Fax #: (916) 653-3135

Secondary Contact Person, Title, Telephone #, E-mail address: Janie Apodaca /Manager, Cashiering/Revolving Fund / (916) 327-4159/ APODACJ@HDCDOJNET.STATE.CA. US

Address: Department of Justice, 1300 I Street, Suite 125, Sacramento, California 95814; P.O. Box 944255, Sacramento, California 94244-2550

Fax #: (916) 323-0708

ATTACHMENT B

Eligible Cities and Counties

City/County	MOU Proportional Allocable Share
County of Alameda	0.038684912
County of Alpine	0.000033659
County of Amador	0.000908437
County of Butte	0.005507657
County of Calaveras	0.000967681
County of Colusa	0.000492187
County of Contra Costa	0.024306394
County of Del Norte	0.000709475
County of El Dorado	0.003810330
County of Fresno	0.020186175
County of Glenn	0.000749939
County of Humboldt	0.003602356
County of Imperial	0.003305532
County of Inyo	0.000552852
County of Kern	0.016435785
County of Kings	0.003068617
County of Lake	0.001551178
County of Lassen	0.000834616
County of Los Angeles	0.268039045
City of Los Angeles	0.025000000
County of Madera	0.002664010
County of Marin	0.006958543
County of Mariposa	0.000432520
County of Mendocino	0.002429787
County of Merced	0.005395248
County of Modoc	0.000292681
County of Mono	0.000301088
County of Monterey	0.010755839
County of Napa	0.003349746
County of Nevada	0.002374293
County of Orange	0.072899828
County of Placer	0.005225682
County of Plumas	0.000596945
County of Riverside	0.035395529
County of Sacramento	0.031488456
County of San Benito	0.001109788
County of San Bernardino	0.042894526
County of San Diego	0.075544785
City of San Diego	0.025000000
City and County of San Francisco	0.046893906
County of San Joaquin	0.014535111
County of San Luis Obispo	0.006567395

County of County of San Mateo	0.019645843
County of Santa Barbara	0.011177653
County of Santa Clara	0.045289595
City of San Jose	0.025000000
County of Santa Cruz	0.006947596
County of Shasta	0.004446650
County of Sierra	0.000100343
County of Siskiyou	0.001316461
County of Solano	0.010294983
County of Sonoma	0.011740576
County of Stanislaus	0.011205295
County of Sutter	0.001948033
County of Tehama	0.001500755
County of Trinity	0.000395050
County of Tulare	0.009433088
County of Tuolumne	0.001465402
County of Ventura	0.020232324
County of Yolo	0.004266892
County of Yuba	0.001760926
	==========
	1.000000

ATTACHMENT C

The wiring instructions for the following eligible cities and counties have been provided to Citibank under separate cover.

Alameda County
Alpine County
Amador County
Butte County
Calaveras County
Colusa County
Contra Costa County
Del Norte County
El Dorado County
Fresno County
Glenn County
Humboldt County
Imperial County
Inyo County
Kern County
Kings County
Lake County
Lassen County
Los Angeles County
  City of Los Angeles
Madera County
Marin County
Mariposa County
Mendocino County
Merced County
Modoc County
Mono County
Monterey County
Napa County
Nevada County
Orange County
Placer County
Plumas County
Riverside County
Sacramento County
San Benito County
San Bernardino County
San Diego County
  City of San Diego
San Francisco County
  City of San Francisco
San Joaquin County
San Luis Obispo County
San Mateo County
Santa Barbara County
Santa Clara County
  City of San Jose

Santa Cruz County
Shasta County
Sierra County
Siskiyou County
Solano County
Sonoma County
Stanislaus County
Sutter County
Tehama County
Trinity County
Tulare County
Tuolumne County
Ventura County
Yolo County
Yuba County

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX E
PROPOSED FORM OF OPINION OF BOND COUNSEL

[CLOSING DATE]

Tobacco Securitization Authority of
Southern California
San Diego, California

Tobacco Securitization Authority of Southern California
Tobacco Settlement Asset-Backed Bonds
(San Diego County Tobacco Asset Securitization Corporation)
(Final Opinion)

Ladies and Gentlemen:

We have acted as bond counsel to the Tobacco Securitization Authority of Southern California (the "Authority") in connection with the issuance by the Authority of $534,610,000 principal amount of its Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006A Senior Current Interest Bonds (the "Series 2006A Bonds"), $19,769,609.60 initial principal amount of its Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006B First Subordinate CABs (the "Series 2006B Bonds"), $8,685,657.00 initial principal amount of its Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006C Second Subordinate CABs (the "Series 2006C Bonds") and $20,565,393.85 initial principal amount of its Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006D Third Subordinate CABs (the "Series 2006D Bonds"). The Series 2006A Bonds, Series 2006B Bonds, Series 2006C Bonds and Series 2006D Bonds are collectively referred to herein as the "Series 2006 Bonds." The Series 2006 Bonds are issued pursuant to the provisions of the Joint Exercise of Powers Act (constituting Chapter 5 of Division 7 of Title 1 of the California Government Code) and an Indenture, by and between the Authority and The Bank of New York Trust Company, N.A., as trustee (the "Trustee"), as supplemented by the Series 2006 Supplement, each dated as of May 1, 2006, by and between the Authority and the Trustee (as so supplemented, the "Indenture"). The Indenture provides that the Series 2006 Bonds are issued for the purpose of making a loan of the proceeds thereof to the San Diego County Tobacco Asset Securitization Corporation (the "Corporation") pursuant to a Secured Loan Agreement, dated as of May 1, 2006 (the "Loan Agreement"), by and between the Authority and the Corporation. Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Indenture.

In such connection, we have reviewed the Indenture; the Loan Agreement; the Issuer Tax Certificate; the Corporation Tax Certificate; the County Tax Certificate; opinions of counsel to the Authority, the County and the Corporation; certificates of the Authority, the Trustee, the County, the Corporation 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 Loan Agreement, the Issuer Tax Certificate, the Corporation Tax Certificate, the County Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of Series 2006 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 Series 2006 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 Series 2006 Bonds has concluded with their issuance, and we disclaim any obligation to update this opinion. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority (and, for purposes of the opinion

numbered 3 below, 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 Loan Agreement, the Issuer Tax Certificate, the Corporation Tax Certificate and the County Tax Certificate, 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 Series 2006 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 Series 2006 Bonds, the Indenture, the Loan Agreement, the Issuer Tax Certificate, the Corporation Tax Certificate and the County Tax Certificate 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 limitation on legal remedies against joint powers authorities in the State of California. 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, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or subject to the lien of the Indenture or the Loan Agreement or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. We also express no opinion regarding the accreted value table or calculation set forth or referred to in any of the Bonds or in the Indenture. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Circular or other offering material relating to the Series 2006 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 Series 2006 Bonds constitute the valid and binding limited obligations of the Authority.

2. The Indenture has been duly executed and delivered by, and constitutes the valid and binding obligation of, the Authority. The Indenture creates, as security for the Series 2006 Bonds, a valid pledge of the Collateral, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture.

3. The Loan Agreement has been duly executed and delivered and constitutes a valid and binding agreement of the parties thereto.

4. The Series 2006 Bonds are not a lien or charge upon the funds or property of the Authority except to the extent of the aforementioned pledge. Neither the faith and credit nor the taxing power of the State of California or of any political subdivision thereof, including the County, is pledged to the payment of the principal of or interest on the Series 2006 Bonds. The Series 2006 Bonds are not a debt of the State of California or any member of the Authority, including the County, and neither said State nor any such member is liable for the payment thereof.

5. Interest on the Series 2006 Bonds, including any original issue discount, is excluded from gross income for federal income tax purposes under Section 103 of the Code and is exempt from State of California personal income taxes. Interest on the Series 2006 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 when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006 Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

APPENDIX F

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following is a summary of certain provisions of the Indenture, the Loan Agreement and Purchase and Sale Agreement which are not described elsewhere in this Offering Circular. These summaries do not purport to be to be complete or definitive and reference should be made to such documents for a full and complete statement of their provisions. See "THE SERIES 2006 BONDS" and "SECURITY FOR THE SERIES 2006 BONDS" for further descriptions of certain terms and provisions of the Series 2006 Bonds. All capitalized terms not defined in this Offering Circular have the meanings set forth in the Indenture.

DEFINITIONS

The following are definitions of certain terms used in this Summary of Principal Legal Documents or elsewhere in this Offering Circular.

"Accounts" means the accounts established under the provisions of the Indenture.

"Accreted Value" means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest accrued thereon from its date, compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through and including the Maturity Date or earlier redemption date of such Bond, or in the case of a Convertible Bond, through and excluding the applicable Conversion Date or through and including the earlier redemption date of such Bond) at the "original issue yield" for such Bond, as set forth in the related Series Supplement; provided, however, that the Authority shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the related Series Supplement by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Dates. The term "original issue yield" means, with respect to any particular Bond, the yield to the applicable Maturity Date of such Bond from the initial date of delivery thereof calculated on the basis of semiannual compounding on each Distribution Date.

"Additional Bonds" has the meaning given to such term in the Indenture. See "INDENTURE – The Bonds" herein.

"Additional Subordinate Bonds" has the meaning given to such term in the Indenture. See "INDENTURE – The Bonds" herein.

"ARIMOU" means the Agreement Regarding the Interpretation of the Memorandum of Understanding, among the State and certain other signatories thereto, as amended or supplemented.

"Authority" means the Tobacco Securitization Authority of Southern California, a public entity of the State, and its successors or assigns.

"Authority Tax Certificate" means the Tax Certificate executed by the Authority at the time of issuance of Series 2006 Bonds and each subsequent Series of Tax-Exempt Bonds, each as amended or supplemented.

"Authorized Denomination" means the authorized denomination of any Series of Bonds as set forth in the applicable Series Supplement.

"Basic Documents" means the Indenture, the Purchase and Sale Agreement, the Loan Agreement, the Authority Tax Certificate, the Corporation Tax Certificate and the County Tax Certificate, or any similar documents relating to Additional Bonds or Additional Subordinate Bonds or bonds issued by the Authority to refund the Bonds.

"Board of Directors " means the governing board of the Authority.

"Bond Obligation" means, as of any given date of calculation, (a) with respect to any Outstanding Current Interest Bond, the principal amount of such Current Interest Bond, and (b) with respect to any Outstanding Capital Appreciation Bond, the Accreted Value thereof as of such date.

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

"Bonds" means the Series 2006 Bonds, any Additional Bonds and any Additional Subordinate Bonds.

"Business Day" means any day other than a Saturday, a Sunday, or a day on which banking institutions in New York, New York, San Diego, California, or the city in which the Corporate Trust Office is located are required or authorized by law to be closed.

"California Escrow" means the account established and maintained for the benefit of the State under the California Escrow Agreement.

"California Escrow Agent" means Citibank, N.A., acting in its capacity as escrow agent under the California Escrow Agreement, or its successor in such capacity, as provided in the California Escrow Agreement.

"California Escrow Agreement" means that certain escrow agreement, dated April 12, 2000, as amended by the first amendment to escrow agreement, dated July 19, 2001, between the Attorney General of the State, on behalf of the State and the California Escrow Agent, as amended or supplemented.

"Capital Appreciation Bond" means a Bond (including, as the context requires, a Convertible Bond prior to the applicable Conversion Date), the interest on which is compounded on each Distribution Date, commencing on the first Distribution Date after its issuance through (1) and including the Maturity Date or earlier redemption date of such Bond in the case of a Capital Appreciation Bond which is not a Convertible Bond, or (2) and excluding the Conversion Date or including the earlier redemption date in the case of a Convertible Bond.

"Closing Date" means the date of original issuance of the Series 2006 Bonds.

"Code" means the Internal Revenue Code of 1986, as amended.

"Collateral" has the meaning ascribed thereto in the Indenture. See "INDENTURE – Security Interest and Pledge" herein.

"Collections" means all funds collected with respect to TSRs, amounts paid to the Authority under any Swap Contract and investment earnings on the Pledged Accounts.

"Consent Decree" means that certain consent decree and final judgment entered by the Superior Court of the State of California, County of San Diego on December 9, 1998 in Case No. J.C.C.P. 4041.

"Conversion Date" means the date set forth in the applicable Series Supplement on and after which a Convertible Bond is deemed a Current Interest Bond and after which the Owners shall be entitled to current payments of interest on each Distribution Date.

"Convertible Bond" means a Capital Appreciation Bond which is deemed to be a Current Interest Bond on and after the applicable Conversion Date.

"Corporate Trust Office" means the office of the Trustee at which the corporate trust business of the Trustee related to the Indenture shall, at any particular time, be principally administered, which office is, at the date of the Indenture, located at 515 Flower Street, Los Angeles, CA 90017, except that with respect to presentation of Bonds for payment or for registration of transfer and exchange such term shall mean the office or agency of the Trustee at which, at any particular time, its corporate trust agency business shall be conducted.

"Corporation" means the San Diego County Tobacco Asset Securitization Corporation, a nonprofit public benefit corporation created under the California Nonprofit Public Benefit Corporation Law.

"Corporation Tobacco Assets" has the meaning ascribed thereto in the Loan Agreement. See "LOAN AGREEMENT – Grant of Security Interest" herein.

"Corporation Tax Certificate" means the Corporation Tax Certificate executed by the Corporation at the time of issuance of the Series 2006 Bonds and each subsequent Series of Tax-Exempt Bonds, each as amended or supplemented.

"Costs of Issuance" means any item of expense directly or indirectly payable or reimbursable by the Authority and related to the authorization, sale and issuance of Bonds, including, but not limited to, underwriting fees, auditors' or accountants' fees, printing costs, costs of reproducing documents, filing and recording fees, fees and expenses of fiduciaries, including the Trustee, legal fees and charges, professional consultants' fees, costs of credit ratings, fees and charges for execution, transportation and safekeeping of Bonds, governmental charges, initial charges to acquire liability insurance and other costs, charges, and fees in connection with the foregoing.

"Counsel" means nationally recognized bond counsel or such other counsel as may be selected by the Authority for a specific purpose under the Indenture.

"County" means the County of San Diego, a political subdivision of the State.

"County Tax Certificate" means the County Tax Certificate executed by the County at the time of issuance of the Series 2006 Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the provisions thereof.

"Current Interest Bond" means a Bond (including, as the context requires, a Convertible Bond on and after the applicable Conversion Date), the interest on which is payable currently on each Distribution Date.

"Default Rate" means the rate of interest per annum set forth in a Series Supplement at which the First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds will accrete on and during the continuance of a Subordinate Payment Default for such Bonds as set forth in the Series Supplement for such Bonds.

"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 of the State; (ii) obligations, the timely payment of the principal and interest on which are unconditionally guaranteed by the State or the United States government; (iii) certificates of deposit of banks or trust companies in the State, secured, if the Authority shall so require, by obligations of the United States of America of a market value equal at all times to the amount of the deposit; (iv) 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; (v) 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 (vi) general obligation bonds and notes of any state other than the State, and bonds and notes of any county (other than the County), city, fire district or school district of the State; provided that the above-listed investments are not redeemable at the option of the issuer thereof and shall 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 institution acting as Trustee or by a Paying Agent or as a Paying Agent or by an affiliate of the institution acting as 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 shall be rated at the time of the investment in the highest long-term rating category by each Rating Agency; or

(e) investment arrangements that are rated, or with providers whose senior unsecured debt obligations are rated in the highest long-term and short-term 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.

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

"Depository" means DTC and any substitute for or successor to such depository that shall, at the request of the Authority, maintain a Book-Entry System with respect to the Bonds.

"Depository Nominee" means the Depository or the nominee of the Depository in whose name the Bonds are registered during the continuation with such Depository of participation in its Book Entry System.

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

"DTC" means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and includes any nominee of DTC in whose name any Bonds are then registered.

"Eligible Bank" means any (i) bank or trust company organized under the laws of any state of the United States of America, (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 under the laws of the United States, or (iv) federal branch or agency as defined 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)(i) Bonds, notes and other evidences of indebtedness of the State, and securities unconditionally guaranteed as to the payment of principal and interest by the State;

(ii) Revenue bonds, revenue notes or other evidences of revenue indebtedness issued by agencies or authorities of the State; and

(iii) Bonds, notes and other evidences of indebtedness of any county (other than the County), city, district, authority or other public body in the State, provided that such bonds, notes and other evidences of indebtedness are (x) direct legal obligations of the public body, for the payment of which the public body has

pledged its full faith and credit and unlimited taxing power, or (y) unconditionally guaranteed as to the payments of principal and interest by the public body.

In every case referred to in paragraphs (a)(i), (ii), or (iii) above, such bonds, notes or other evidences of indebtedness shall be rated in one of the three highest rating categories of at least one Rating Agency and not rated in a category lower than the three highest rating categories of any Rating Agency. Determination of an obligation's rating in one of the three highest rating categories shall be made without regard to any refinement or gradation of such rating category by numerical or other modifier. In addition, the remaining maturity of such bonds, notes or other evidences of indebtedness shall not be greater than five years.

(iv) Bonds, notes and other obligations of the United States, and securities unconditionally guaranteed as to the payment of principal and interest by the United States with a remaining maturity not greater than five years, except in the case of savings bonds, which may have a longer maturity. The obligations enumerated in this paragraph may be held directly or in the form of repurchase agreements collateralized by such obligations or in the form of securities of any open-end or closed-end management type investment company or investment trust registered under the Investment Company Act of 1940, provided that the portfolio of such investment company or investment trust is limited to such obligations or repurchase agreements collateralized by such obligations, or securities of other such investment companies or investment trusts whose portfolios are so restricted;

(v) Savings accounts, time deposits or certificates of deposit in any bank, savings bank, trust company, savings and loan association or credit union authorized to do business as such in the State, but only to the extent that such accounts, deposits or certificates are fully insured by the Federal Deposit Insurance Corporation or any successor to it or by the National Credit Union Share Insurance Fund or any successor to it; and

(b)(i) Defeasance Collateral;

(ii) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, Fannie Mae, FHLB, the Federal Farm Credit System or the Tennessee Valley Authority;

(iii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank (including the institution acting as 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 "F 1" by Fitch;

(iv) certificates, notes, warrants, bonds, obligations, or other evidences of indebtedness of a state or a political subdivision thereof (other than the County) rated by each Rating Agency maintaining a rating thereon in one of its three highest ratings categories;

(v) 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 "A-1" by S&P, "P-1" by Moody's and "F1" by Fitch, if rated by Fitch;

(vi) repurchase obligations with respect to any security described in paragraphs (b)(i), (ii) or (iii) above entered into with a primary dealer, depository institution, or trust company (acting as principal) rated "A-1+" by S&P, "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 two highest long term rating categories, or collateralized by securities described in paragraphs (b)(i), (ii) or (iii) 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 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 has 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 equal to at least 102% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended;

(vii) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated "A-1+" by S&P, "P-1" by Moody's and "F 1" by Fitch, if rated by Fitch, at the time such investment or contractual commitment providing for such investment is made; provided that securities issued by any such corporation will not be Eligible Investments to the extent that investment therein would cause the then-outstanding principal amount of securities issued by such corporation that are then held to exceed 20% of the aggregate principal amount of all Eligible Investments then held;

(viii) units of taxable or tax-exempt money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated by each Rating Agency maintaining a rating thereon in one of its three highest rating categories, including, if so rated, any such fund which the institution acting as Trustee or an affiliate thereof serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian;

(ix) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, by each Rating Agency maintaining a rating thereon in one of its three highest rating categories, if the Authority has an option to terminate such agreement in the event that such rating is downgraded below the rating on the Bonds, or if not so rated, then collateralized by securities described in paragraphs (b)(i), (ii) or (iii) 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 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 has 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 equal to at least 102% or, if greater, the amount then required by S&P in order that the ratings then assigned by S&P to the Bonds will not be lowered or suspended;

(x) Amended and Restated Debt Service Reserve Account Forward Delivery Agreement, dated as of May 26, 2006, amending and restating a Debt Service Reserve Account Forward Delivery Agreement, dated January 4, 2002, among the Authority, the Trustee and Bayerische Hypo-und Vereinsbank AG, New York Branch; and

(xi) other obligations or securities that are non-callable and that are acceptable to each Rating Agency; provided, that no Eligible Investment may (i) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument, (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, or (iii) be issued by or an obligation of the County.

"Event of Default" means an event specified in the Indenture. See "INDENTURE – Events of Default" herein.

"Fannie Mae" means the Federal National Mortgage Association.

"FHLB" means a Federal Home Loan Bank.

"FHLMC" means the Federal Home Loan Mortgage Corporation.

"Fiduciary" means the Trustee, each Paying Agent and the Registrar.

"First Subordinate Bonds" means the Series 2006 First Subordinate Bonds and Additional Bonds identified as First Subordinate Bonds in a Series Supplement.

"First Subordinate Capital Appreciation Bond" means a Capital Appreciation Bond that is identified as a First Subordinate Bond in a Series Supplement.

"Fiscal Year" means the 12-month period ending each June 30, or such other 12-month period as the Board of Directors may determine from time to time to be the Authority's fiscal year. In the event that the Board of Directors changes the Authority's Fiscal Year, the Authority shall deliver an officer's certificate to the Trustee stating such change.

"Fitch" means Fitch Inc., its successors and assigns and, if such corporation shall no longer perform the functions of a securities rating agency, the term "Fitch" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority by notice to the Trustee. References to Fitch are effective for so long as Fitch is a Rating Agency rating all or a portion of the Outstanding Bonds.

"Fully Paid" has the meaning given to such term in the Indenture. See "INDENTURE – Payment of Bonds; Satisfaction and Discharge of Indenture" herein.

"Indenture" means the Indenture, as amended or supplemented.

"Indirect Participant" means a broker-dealer, bank or other financial institution who holds Bonds through a Participant.

"JPA Agreement" means the Amended and Restated Joint Exercise of Powers Agreement creating the Authority, between the County and the County of Sacramento, as amended or supplemented.

"Loan" has the meaning ascribed thereto in the Loan Agreement. See "LOAN AGREEMENT – Issuance of Bonds; Deposit of Proceeds" herein.

"Loan Agreement" means the Secured Loan Agreement, dated as of May 1, 2006, between the Authority, as lender, and the Corporation, as borrower, as amended or supplemented.

"Loan Payments" has the meaning ascribed thereto in the Loan Agreement. "See "LOAN AGREEMENT – Amounts Payable" herein.

"Lump Sum Payment" means a final payment from a Participating Manufacturer that results in, or is due to, a release of that Participating Manufacturer from all of its future payment obligations under the MSA. Any Lump Sum Payment shall be applied as Collections as provided in the Indenture. The term "Lump Sum Payment" does not include any payments that are Partial Lump Sum Payments, Total Lump Sum Payments or any non-scheduled prepayments other than a Lump Sum Payment.

"Majority in Interest" means the Owners of a majority of the Bond Obligation of Outstanding Bonds eligible to act on a matter.

"Master Settlement Agreement" or "MSA" means the Master Settlement Agreement entered into on November 23, 1998, among the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Southern Mariana Islands and the OPMs, as amended or supplemented.

"Maturity Date" means, with respect to any Bond, the final date on which all remaining principal or Accreted Value of such Bond is due and payable.

"Moody's" means Moody's Investors Service, its successors and assigns and, if such corporation shall no longer perform the functions of a securities rating agency, the term "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority by notice to the Trustee. References to Moody's are effective for so long as Moody's is a Rating Agency rating all or a portion of the Outstanding Bonds.

"MOU" means the Memorandum of Understanding, dated August 5, 1998, among the Attorney General's Office of the State and certain other signatories thereto, as amended or supplemented.

"Operating Cap" means (i) $200,000 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.

"Operating Expenses" means the reasonable operating and administrative expenses of each of the Authority and the Corporation (including, without limitation, the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, insurance premiums, deductibles and retention payments, and costs of meetings or other required activities of the Authority or the Corporation), legal fees and expenses of the Authority and the Corporation, its respective directors, officers and employees, fees and expenses incurred for professional consultants and fiduciaries (including, but not limited to, computation of the amount of Tax Obligations and related computations), the fees, expenses, and disbursements of the Trustee, including the fees and expenses of counsel to the Trustee, Termination Payments, the costs incurred, as determined by the County, in order to preserve the tax-exempt status of any Tax-Exempt Bonds, the costs related to enforcement of the County's rights under the MOU or the ARIMOU, the costs related to the Authority's or the Corporation's or the Trustee's enforcement rights with respect to the Basic Documents, and all Operating Expenses so identified in the Indenture. The term "Operating Expenses" does not include the Costs of Issuance.

"Opinion of Counsel" means a written opinion of Counsel.

"OPM" means the Original Participating Manufacturer, as defined in the MSA.

"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 the principal or Accreted Value; (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 shall 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 Authority, or any Person controlling, controlled by, or under common control with the Authority. 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.

"Owners" and similar terms mean the registered owners of the Bonds from time to time as shown on the books of the Trustee. Unless and until Bonds have been issued to Owners other than the Depository, all references to "Owners" of the Bonds are qualified by reference to the Indenture.

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

"Participant" means a broker-dealer, bank or other financial institution for which the Depository holds Bonds.

"Participating Manufacturer" has the meaning given to such term in the Master Settlement Agreement.

"Paying Agent" means each Paying Agent designated from time to time pursuant to the Indenture.

"Payment Priorities" means payment of Bonds in the following order of priority:

(1) first, the Senior Bonds are Fully Paid in chronological order of Serial Maturities, Sinking Fund Installments and Maturity Dates therefor;

(2) second, the First Subordinate Bonds are Fully Paid;

(3) third, the Second Subordinate Bonds are Fully Paid;

(4) fourth, the Third Subordinate Bonds are Fully Paid; and

(5) fifth, any Additional Subordinate Bonds are Fully Paid in accordance with the provisions of the applicable Series Supplement.

Each clause above is referred to in the Indenture as a "Payment Priority."

"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, whether or not a legal entity.

"Pledged Accounts" means 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 Senior Debt Service Account, the Partial Lump Sum Payment Account, the Senior Liquidity Reserve Account, the Senior Turbo Redemption Account, the First Subordinate Turbo Redemption Account, the Second Subordinate Turbo Redemption Account and the Third Subordinate Turbo Redemption Account. The term "Pledged Accounts" shall also include all subaccounts contained in the named accounts.

"Pro Rata" means, for an allocation of available amounts to any payment of interest, Accreted Value, 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 the Authority 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.

"Pro Rata Defeasance Redemption Schedule" shall have the meaning set forth therefor in the Indenture. See "INDENTURE – Defeasance" herein.

"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 Term Bonds, the schedule of projected Outstanding balances of such Turbo Term Bonds set forth in the related Series Supplement.

"Purchase and Sale Agreement" means the Purchase and Sale Agreement dated as of December 1, 2001 between the County and the Corporation, as amended or supplemented.

"Rating Agency" means each nationally recognized securities rating service that has, at the request of the Authority, a rating then in effect for all or a portion of Outstanding Bonds.

"Rating Confirmation" means evidence that no rating that has been requested by the Authority and is then in effect from a Rating Agency with respect to a Bond will be withdrawn, reduced, or suspended solely as a result of

an action to be taken under the Indenture, provided that this 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 Requirement" shall have the meaning ascribed thereto in the Authority Tax Certificate.

"Record Date" means the 15th day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs whether or not such day is a Business Day. The Authority or the Trustee may in its discretion establish special record dates for the determination of the Owners for various purposes hereof, including giving consent or direction to the Trustee.

"Refunding Bonds" means Additional Bonds, other than the Series 2006 Bonds and the Additional Subordinate Bonds, issued pursuant to the Indenture for the purposes of refunding any Outstanding Bonds.

"Registrar" means an agent designated by the Authority to maintain the registration books for the Bonds.

"Required Defeasance Amortization" means the mandatory redemption of Defeased Turbo Term Bonds required by the provisions of the Indenture.

"S&P" means Standard & Poor's Ratings Services Group, a division of The McGraw-Hill Companies, Inc., its successors and assigns and, if such entity shall no longer perform the functions of a securities rating agency, the term "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority by notice to the Trustee. References to S&P are effective for so long as S&P is a Rating Agency rating all or a portion of the Outstanding Bonds.

"Second Subordinate Bonds" means the Series 2006 Second Subordinate Bonds and Additional Bonds identified as Second Subordinate Bonds in a Series Supplement.

"Second Subordinate Capital Appreciation Bond" means a Capital Appreciation Bond that is identified as a Second Subordinate Bond in a Series Supplement.

"Senior Bonds" means the Series 2006 Senior Bonds and Additional Bonds identified as Senior Bonds in a Series Supplement.

"Senior Capital Appreciation Bond" means a Capital Appreciation Bond that is identified as a Senior Bond in a Series Supplement.

"Senior Convertible Bond" means a Convertible Bond that is identified as a Senior Bond in a Series Supplement.

"Senior Current Interest Bond" means a Current Interest Bond that is identified as a Senior Bond in a Series Supplement.

"Senior Liquidity Reserve Requirement" means an amount equal to $33,274,125.00 for so long as any Series 2006 Senior Bonds are Outstanding and an amount equal to $0 when no Series 2006 Senior Bonds are Outstanding, which amount may (but is not required to) be amended upon the issuance of Additional Bonds that constitute Senior Bonds in accordance with the applicable Series Supplement.

"Serial Bonds" means those Bonds identified as Serial Bonds in a Series Supplement.

"Serial Maturity" means the principal amount or Accreted Value of Serial Bonds due in any year as set forth in a Series Supplement.

"Series" means all Bonds so identified in a Series Supplement, regardless of variations in class, Maturity Date, interest rate or other provisions, and any Bonds thereafter delivered in exchange or replacement therefor.

"Series 2001 Bonds" means the Issuer's $398,105,000 Tobacco Settlement Asset-Backed Bonds, Series 2001A (Senior) (San Diego County Tobacco Asset Securitization Corporation), dated January 4, 2002 and the Issuer's $68,735,000 Tobacco Settlement Asset-Backed Bonds, Series 2001B (Subordinate) (San Diego County Tobacco Asset Securitization Corporation), dated January 4, 2002, including, in each case, any bonds issued in exchange or replacement therefor.

"Series 2006 Bonds" means the Series 2006 Senior Bonds, the Series 2006 First Subordinate Bonds, the Series 2006 Second Subordinate Bonds and the Series 2006 Third Subordinate Bonds issued pursuant to the Indenture and the Series 2006 Supplement.

"Series 2006 First Subordinate Bonds" means the Authority's Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006B First Subordinate Capital Appreciation Bonds.

"Series 2006 Second Subordinate Bonds" the Authority's Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006C Second Subordinate Capital Appreciation Bonds.

"Series 2006 Senior Bonds" means the Authority's Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006A Senior Current Interest Bonds.

"Series 2006 Supplement" means the Series Supplement authorizing the Series 2006 Bonds.

"Series 2006 Third Subordinate Bonds" means the Authority's Tobacco Settlement Asset-Backed Bonds (San Diego County Tobacco Asset Securitization Corporation), Series 2006D Third Subordinate Capital Appreciation Bonds.

"Series Supplement" means the Series 2006 Supplement and any other Supplemental Indenture providing for the issuance of a Series of Additional Bonds or Additional Subordinate Bonds in accordance with the Indenture.

"Sinking Fund Installment" means each respective payment of principal or Accreted Value to be made on Turbo Term Bonds that are Senior Bonds scheduled to be made from amounts available therefor in the Senior Debt Service Account and the Partial Lump Sum Payment Account pursuant to the Indenture, as such schedule is set forth in a Series Supplement.

"State" means the State of California.

"Subordinate Payment Default" means a failure to pay when due interest or principal or Accreted Value at maturity on any First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds or Additional Subordinate Bonds.

"Supplemental Indenture" means a Series Supplement or other supplement to or amendment of the Indenture executed and delivered in accordance with the terms thereof. 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.

"Swap Contract" means an interest rate exchange, cap, collar, hedge or similar agreement entered into by the Authority in connection with Senior Bonds.

"Swap Payment" means any payment with respect to a Swap Contract, other than any Termination Payment with respect to a Swap Contract.

"Taxable Bonds" means all Bonds other than Tax-Exempt Bonds.

"Tax-Exempt Bonds" means all Bonds identified as Tax-Exempt Bonds in any Series Supplement.

"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 Code.

"Term Bond Maturity" means the payment of principal or Accreted Value required to be made upon the final Maturity Date of any Term Bond, as such schedule is set forth in a Series Supplement.

"Term Bonds" means those Bonds identified as Term Bonds in a Series Supplement.

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

"Third Subordinate Bonds" means the Series 2006 Third Subordinate Bonds and Additional Bonds identified as Third Subordinate Bonds in a Series Supplement.

"Third Subordinate Capital Appreciation Bond" means a Capital Appreciation Bond that is identified as a Third Subordinate Bond in a Series Supplement.

"Tobacco Settlement Revenues" or "TSRs" means, without duplication, such of the Collateral as consists of payments received pursuant to the MOU, the ARIMOU, the MSA and the Consent Decree.

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

"Trustee" means The Bank of New York Trust Company, N.A., acting in its capacity as trustee under the Indenture, or its successor, as provided in the Indenture.

"Turbo Redemptions" means (a) with respect to Turbo Term Bonds that are Senior Bonds, the redemption of such Turbo Term Bonds from amounts on deposit in the Senior Turbo Redemption Account pursuant to the Indenture, (b) with respect to Turbo Term Bonds that are First Subordinate Bonds, the redemption of such Turbo Term Bonds from amounts on deposit in the First Subordinate Turbo Redemption Account pursuant to the Indenture, (c) with respect to Turbo Term Bonds that are Second Subordinate Bonds, the redemption of such Turbo Term Bonds from amounts on deposit in the Second Subordinate Turbo Redemption Account pursuant to the Indenture and (d) with respect to Turbo Term Bonds that are Third Subordinate Bonds, the redemption of such Turbo Term Bonds from amounts on deposit in the Third Subordinate Turbo Redemption Account pursuant to the Indenture.

"Turbo Term Bonds" means the Term Bonds identified as Turbo Term Bonds in a Series Supplement.

"Turbo Term Bond Maturity" means the payment of principal or Accreted Value required to be made upon the Maturity Date of any Turbo Term Bond, as such schedule is set forth in a Series Supplement.

"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 and also means facsimile transmission.

INDENTURE

The Indenture sets forth the terms of the Bonds, the nature and extent of the security, various rights of the Bondholders, rights, duties and immunities of the Trustee and the rights and obligations of the Authority. Certain provisions of the Indenture are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Indenture.

Security Interest and Pledge

In order to secure payment of the Bonds and the Swap Payments, all with the respective priorities specified in the Indenture, the Authority pledges to the Trustee, and grants to the Trustee a first priority lien and security interest in, all of the Authority's right, title, and interest, in, to, and under: (i) the Authority's rights with respect to the Loan Agreement, including but not limited to the right to receive Loan Payments and to enforce the obligations of the Corporation pursuant to the Loan Agreement; (ii) the Corporation Tobacco Assets; (iii) the Pledged Accounts, all money, instruments, investment property, and other property credited to or on deposit in the Pledged Accounts, and all investment earnings thereon; (iv) any payment received by the Authority pursuant to a Swap Contract; (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, payment intangibles and other property that at any time constitute all or part of or are included in the proceeds of any of the foregoing; and (vi) all proceeds of the foregoing. The property described in the preceding sentence is referred to in the Indenture as the "Collateral." The Collateral does not include the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Owners. The Authority covenants and agrees that it will implement, protect, and defend this security interest and pledge by all appropriate action for the benefit of the Owners and any party that has entered into a Swap Contract, the cost thereof to be an Operating Expense.

The pledge of Collateral shall be valid and binding from the date of execution of the Indenture, and amounts so pledged and thereafter received shall immediately be subject to the lien of the pledge without any physical delivery thereof or further act, and the lien of such pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Authority, irrespective of whether such parties have notice thereof and the Indenture need not be recorded or filed to perfect such pledge.

None of the proceeds of the Bonds or any earnings therefrom, unless deposited into one of the Pledged Accounts, shall in any way be pledged to the payment of the Bonds. Such amounts shall not be part of the Collateral.

Defeasance

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 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 shall have been duly given in accordance with the Indenture or irrevocable instructions to give notice shall have been given to the Trustee, (iii) all the rights under the Indenture of the Fiduciaries and counterparties to Swap Contracts have been provided for and all Operating Expenses have been satisfied in accordance with the Indenture, and (iv) the Trustee shall have received an Opinion of Counsel to the effect that such defeasance will not, in and of itself, cause interest on any Tax-Exempt Bond to be included in gross income for federal income tax purposes, then upon Written Notice from the Authority to the Trustee, such Owners and counterparties to Swap Contracts shall 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, the Indenture and the lien, rights and security interests created by the Indenture (except in such funds and investments) shall terminate and become null and void. Upon such defeasance, the funds and investments required to pay or redeem the Bonds shall be irrevocably set aside for that purpose, subject, however, to the Indenture, and money held for defeasance shall be invested only as provided above in this section and applied by the Trustee and other Paying Agents, if any, to the retirement of the Bonds. Any funds or other property held by the Trustee and not required for payment or redemption of the Bonds shall be distributed in accordance with the order of the Authority. Upon the discharge of the Trustee's lien and security interests created under the Indenture, the Trustee and the Authority shall cooperate in delivering instructions to the Attorney General of the State to instruct the California Escrow Agent to transfer the TSRs to or upon the order of the Corporation.

Partial Defeasance. Subject to the requirements of the Indenture, the Authority may create a defeasance escrow for the retirement and defeasance of any Bonds subject to and in accordance with the Indenture. Thereafter, the Owners of such Defeased Bonds and counterparties to such related Swap Contracts shall 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.

Defeasance of Turbo Term Bonds. For each Defeased Turbo Term Bond of the same Maturity Date and Series, the Authority must determine a "Pro Rata Defeasance Redemption Schedule" as described below. In establishing the defeasance escrow, the Defeased Turbo Term Bonds may not be redeemed more slowly than the Pro Rata Defeasance Redemption Schedule.

For a given Turbo Term Bond Maturity of a given Series, the Trustee shall determine the Pro Rata portion of each Projected Turbo Redemption (shown, with respect to each Series of the Series 2006 Bonds, in the Series 2006 Supplement) that is allocable to the Defeased Turbo Term Bonds. The Pro Rata portion of each Projected Turbo Redemption shall be calculated as of the date of the defeasance by: (a) deducting the Turbo Redemptions which have already occurred from the earliest Projected Turbo Redemptions to arrive at a schedule of "Projected Turbo Redemptions Adjusted for Prior Payments"; (b) calculating a ratio of the Bond Obligation to be defeased of each Turbo Term Bond Maturity divided by the then Outstanding Bond Obligation of the Turbo Term Bond Maturity; and (c) applying that ratio to the Projected Turbo Redemptions Adjusted for Prior Payments, resulting in a schedule for each Turbo Term Bond Maturity defined as the "Pro Rata Defeasance Redemption Schedule."

For each Defeased Turbo Term Bond of the same Maturity Date and Series, the Trustee shall establish a defeasance escrow which: (a) redeems on the earliest possible date the Pro Rata Defeasance Redemptions which were originally projected to occur prior to the date of the defeasance, if any; and (b) thereafter, redeems the Pro Rata Defeasance Redemptions according to their schedule.

In order to establish the Projected Turbo Redemption Schedule in effect for each Turbo Term Bond Maturity of a given Series after each partial defeasance, the Trustee shall determine the schedule of Projected Turbo Redemptions Adjusted for Prior Payments then applicable and permanently subtract the Pro Rata Defeasance Redemption Schedule from such schedule of Projected Turbo Redemptions Adjusted for Prior Payments.

The provisions described above do not limit the optional redemption of Bonds of a Series pursuant to the applicable Series Supplement.

Payment of Bonds; Satisfaction and Discharge of Indenture

Whenever all Bonds have been Fully Paid, all Swap Payments have been paid and the requirements of the Indenture have been met, then, upon Written Notice from the Authority to the Trustee (and subject to the Indenture for Bonds that are deemed Fully Paid in accordance with the Indenture), the Indenture and the lien, rights and security interests created by the Indenture shall terminate and become null and void, and the Authority and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture. Any funds or other property held by the Trustee and not required for payment or redemption of the Bonds shall be distributed in accordance with the order of the Authority. Upon the discharge of the Trustee's lien and security interests created under the Indenture, the Trustee and the Authority shall cooperate in delivering instructions to the Attorney General of the State to instruct the California Escrow Agent to transfer the TSRs to or upon the order of the Corporation.

A Bond shall be deemed "Fully Paid" only: if (1)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 (2) such Bond shall have matured or been called for redemption and, on such Maturity Date or redemption date, money for the payment of the principal or Accreted Value 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 (3) such Bond is alleged to have been lost, stolen, destroyed, partially destroyed, or defaced and has been replaced as provided in the Indenture; or (4) 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). Prior to any satisfaction and discharge of the Indenture, the Authority shall satisfy all Operating Expenses.

The Bonds

(a) By Series Supplements complying procedurally and in substance with the Indenture, the Authority may authorize, issue, sell and deliver the Series 2006 Bonds and one or more Series of Additional Bonds or Additional Subordinate Bonds from time to time with such principal amounts and Accreted Values at maturity as the Authority shall determine. The Bonds of each Series shall bear such dates, mature at such times, be subject to such terms of payment, bear interest or accrete at such rates, be in such form and Authorized Denomination, carry such registration privileges and transfer restrictions, if any, be executed in such manner, and be payable in such medium of payment, at such place and subject to such terms of redemption, as the Authority may provide herein and in the related Series Supplement. The proceeds of the Series 2006 Bonds shall be applied as provided in the Indenture and the proceeds of each other Series of Bonds shall be applied as provided in the Indenture and the related Series Supplement. The Series Supplement shall identify whether the Bonds of any Series are Senior Bonds, First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds or Additional Subordinate Bonds and whether such Bonds are Current Interest Bonds or Capital Appreciation Bonds or Convertible Bonds.

(b) (i) Additional Bonds may be issued to refund all Bonds in whole (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance). Nothing in the Indenture is intended to limit the ability of the Authority to issue bonds to refund all Bonds in whole pursuant to a new indenture.

(ii) Additional Bonds may be issued to refund Bonds in part (including the funding of defeasance escrows and deposits to Accounts in connection with such issuance) or for any other purpose but only if upon the issuance of such Additional Bonds: (A) the amount on deposit in the Senior Liquidity Reserve Account will be at least equal to the Senior Liquidity Reserve Requirement; (B) no Event of Default shall have occurred and be continuing after the date of issuance of the Additional Bonds; (C) the expected weighted average life of each Turbo Term Bond that will remain Outstanding after the date of issuance of the Additional Bonds as computed on the basis of new projections on the date of sale of the Additional Bonds will not exceed (x) the remaining weighted average life of each such Turbo Term Bond as computed on the basis of new projections assuming that no such Additional Bonds are issued plus (y) one year; and (D) a 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. In determining compliance with clause (ii)(C) of this paragraph, the Authority may rely conclusively on a certificate of a financial advisory or underwriting firm, who may rely on a report of a nationally recognized firm of econometric experts on matters related to projected or forecasted cigarette consumption.

(c) One or more Series of Bonds (the "Additional Subordinate Bonds") may be issued without satisfying the requirements of paragraph (b) above, for any lawful purpose, including to refund all or a portion of the Bonds, if there is no payment permitted for such Bonds until all previously issued Bonds are Fully Paid. Each Rating Agency shall be given notice of the issuance of any Additional Subordinate Bonds.

Application of Collections

(a) All Collections received by the Trustee, excluding investment earnings on amounts on deposit in Accounts with the Trustee under the Indenture, shall be promptly deposited by the Trustee into the Collections Account. All Collections that have been identified by an officer's certificate as consisting of Partial Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Partial Lump Sum Payment Account, in accordance with the instructions received by the Trustee pursuant to an officer's certificate. All Collections that have been identified by an officer's certificate as consisting of Total Lump Sum Payments received by the Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) applied as described in paragraph (e) below, in accordance with the instructions received by the Trustee pursuant to an officer's certificate. In addition, immediately preceding the time when the application of funds on deposit in the Collections Account is made pursuant to the following paragraph, the Trustee shall deposit in the Collections Account and apply as described in the following paragraph all Collections consisting of investment earnings available on such date on amounts on deposit with the Trustee under the Indenture (excluding amounts in the Costs of Issuance Account, the Rebate Account, the Operating Account, the Operating Contingency Account and the Partial Lump Sum Payment Account), except that all amounts in the Senior Liquidity Reserve Account in excess of the Senior Liquidity Reserve Requirement determined to exist pursuant to the valuation procedure described in the Indenture, taking into account

investment earnings and other amounts available on such date, shall be transferred to the Senior Debt Service Account (except as otherwise provided in the Indenture) and all investment earnings available on such date in the Capitalized Interest Subaccount shall be maintained in the Senior Debt Service Account.

(b) As soon as is practicable, but in any event no later than the earlier of (x) the fifth Business Day following each Deposit Date, or (y) the Distribution Date following each Deposit Date, the Trustee shall withdraw the funds on deposit in the 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 the officer's certificate relating to Operating Expenses most recently delivered or deemed delivered pursuant to the Indenture in order to pay, for the twelve-month period applicable to such officer's certificate, (x) the Operating Expenses (excluding any Termination Payments) to the extent that the amount thereof does not exceed the Operating Cap, and (y) the Tax Obligations;

(ii) to the Senior 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 (x) interest on the Outstanding Senior Bonds and all Swap Payments that will come due (i) in the next succeeding Bond Year, if the Deposit Date is on or after December 1 and on or before May 31 of any Bond Year, or (ii) in the then-current Bond Year, if the Deposit Date is on or after June 1 and on or before November 30 of any Bond Year, plus (y) any such unpaid interest on the Senior Bonds and 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 paragraph (ii) shall be calculated assuming that principal on the Bonds will have been paid as described in clauses (ii), (iii), and (iv) of paragraph (c) below;

(iii) to the Senior 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, or Sinking Fund Installment, Term Bond Maturity (including Turbo Term Bond Maturities) due for Senior Bonds in or scheduled for the next succeeding Bond Year, plus (b) any such Serial Maturities, Sinking Fund Installment or Term Bond Maturities (including Turbo Term Bond Maturities) unpaid from prior Distribution Dates, provided that the amount of each Sinking Fund Installment and Turbo Term Bond Maturity shall first be adjusted as described in paragraph (e) below;

(iv) unless an Event of Default has occurred, to the Senior Liquidity Reserve Account, an amount sufficient to cause the amount on deposit therein to equal the Senior Liquidity Reserve Requirement, provided that on any Distribution Date on which the amount on deposit in the Senior Liquidity Reserve Account (less any amount necessary to be paid in connection with the liquidation of the investment of amounts in the Senior Liquidity Reserve Account, including a Termination Payment) equals or exceeds the principal or Accreted Value of and interest on all Outstanding Senior Bonds, the amount on deposit in the Senior Liquidity Reserve Account first shall be transferred to the Senior Turbo Redemption Account and applied to the Turbo Redemption of all Outstanding Senior Bonds, and second shall be transferred to the First Subordinate Turbo Redemption Account and applied to the Turbo Redemption of Outstanding First Subordinate Bonds;

(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 relating to Operating Expenses most recently delivered or deemed delivered pursuant to the Indenture in order to pay, for the twelve-month period applicable to such officer's certificate, the Operating Expenses in excess of the Operating Cap;

(vi) to the Senior Turbo Redemption Account, all amounts remaining in the Collections Account until no Senior Bonds are Outstanding;

(vii) to the First Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no First Subordinate Bonds are Outstanding;

(viii) to the Second Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Second Subordinate Bonds are Outstanding; and

(ix) to the Third Subordinate Turbo Redemption Account, all amounts remaining in the Collections Account until no Third Subordinate Bonds are Outstanding.

(c) Unless an Event of Default has occurred, on each Distribution Date the Trustee shall apply amounts in the various Accounts in the following order of priority:

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

(ii) from the Senior Debt Service Account and the Partial Lump Sum Payment Account, in that order, to pay, the Serial Maturity, Sinking Fund Installment and Term Bond Maturity (including Turbo Term Bond Maturity) for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Sinking Fund Installment and Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Sinking Fund Installment or Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iii) from the Senior Liquidity Reserve Account, to pay, in the following order, the Serial Maturity and Term Bond Maturity (including Turbo Term Bond Maturity), if any, for Senior Bonds due on such Distribution Date or unpaid from prior Distribution Dates, provided (x) that the amount of such Turbo Term Bond Maturity shall first have been adjusted as described in the Indenture, (y) that the Trustee shall not pay a Turbo Term Bond Maturity pursuant to this subsection unless the Senior Debt Service Account will contain, after giving effect to such payment, sufficient funds to pay interest due on the next succeeding Distribution Date and (z) all Senior Bonds shall be paid in accordance with clause (1) of the Payment Priorities;

(iv) from the Senior Turbo Redemption Account, to redeem Senior Bonds which are Turbo Term Bonds on such Distribution Date (or a special redemption date) in accordance with the Indenture, provided that all Senior Bonds shall be redeemed in accordance with clause (1) of the Payment Priorities;

(v) from the Partial Lump Sum Payment Account, but only as directed in an officer's certificate delivered by the Authority and accompanied by Rating Confirmation with respect to any Senior Bonds which are then rated by a Rating Agency, to redeem Turbo Term Bonds on such Distribution Date (or a special redemption date) in accordance with the Indenture, provided that any redemptions shall redeem Bonds in accordance with the Payment Priorities;

(vi) from the First Subordinate Turbo Redemption Account, to redeem First Subordinate Bonds on such Distribution Date (or a special redemption date) in accordance with the Indenture;

(vii) from the Second Subordinate Turbo Redemption Account, to redeem Second Subordinate Bonds on such Distribution Date (or a special redemption date) in accordance with the Indenture; and

(viii) from the Third Subordinate Turbo Redemption Account, to redeem Third Subordinate Bonds on such Distribution Date (or a special redemption date) in accordance with the Indenture.

(d) 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:

(i) until the Senior Bonds are no longer Outstanding, the Trustee shall apply all funds in the Senior Debt Service Account, the Senior Liquidity Reserve Account, the Partial Lump Sum Payment Account and the Senior Turbo Redemption Account to pay Pro Rata, first, the accrued interest on the Senior Current Interest Bonds (including Senior Convertible Bonds after the Conversion Date) and Swap Payments (including, in each case, interest at the stated rate on any unpaid interest, to the extent legally permissible) and, second, principal or Accreted Value on all Senior Bonds then Outstanding;

(ii) until the First Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the First Subordinate Turbo Redemption Account to pay Pro Rata the Accreted Value on all First Subordinate Bonds then Outstanding;

(iii) until the Second Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Second Subordinate Turbo Redemption Account to pay Pro Rata, the Accreted Value on all Second Subordinate Bonds;

(iv) until the Third Subordinate Bonds are no longer Outstanding, the Trustee shall apply all funds in the Partial Lump Sum Payment Account and the Third Subordinate Turbo Redemption Account to pay Pro Rata, the Accreted Value on all Third Subordinate Bonds;

(v) the application of funds with respect to Additional Subordinate Bonds shall be in accordance with the provisions of the applicable Series Supplement; and

(vi) notwithstanding anything to the contrary in the Indenture, the value of any Capital Appreciation Bonds that are Series 2006 First Subordinate Bonds, Series 2006 Second Subordinate Bonds or Series 2006 Third Subordinate Bonds shall continue to accrete at the Default Rate (including accretion on any unpaid Accreted Value), to the extent legally permissible, after the Maturity Date for such Bonds if not Fully Paid on the Maturity Date.

(e) Upon the receipt of a sum that has been identified by an officer's certificate as a Total Lump Sum Payment, the Trustee shall, after making provision for the amounts required to be deposited pursuant to paragraph (b)(i) above, use all remaining proceeds of such Total Lump Sum Payments to make the following payments, each Pro Rata, in the following order of priority:

(i) pay the accrued interest on the Senior Current Interest Bonds (including Senior Convertible Bonds after the Conversion Date) and Swap Payments (including interest at the stated rate on any unpaid interest, to the extent legally permissible);

(ii) pay principal or Accreted Value on all Senior Bonds then Outstanding;

(iii) pay principal and interest or Accreted Value on all First Subordinate Bonds then Outstanding;

(iv) pay principal and interest or Accreted Value on all Second Subordinate Bonds then Outstanding;

(v) pay principal and interest or Accreted Value on all Third Subordinate Bonds then Outstanding; and

(vi) pay Additional Subordinate Bonds in accordance with the provisions of the applicable Series Supplement.

After making all deposits and payments set forth above, and provided that there are no Outstanding Bonds and no obligations to make Swap Payments under a Swap Contract, the Trustee shall deliver any amounts remaining in a Fund or Account in accordance with the order of the Authority. Funds in the Operating Account shall be applied by the Trustee at any time, in accordance with directions in an officer's certificate relating to Operating Expenses, to pay Operating Expenses (other than Termination Payments), or to fund an account of the Authority or the Corporation free and clear of the lien of the Indenture for purposes of paying such Operating Expenses. Funds in the Operating Contingency Account shall be applied by the Trustee at any time, in accordance with directions in an officer's certificate, to pay Operating Expenses not otherwise paid from the Operating Account, or to fund an account of the Authority or the Corporation free and clear of the lien of the Indenture for purposes of paying such Operating Expenses.

Rebate

The Trustee shall establish and maintain when required an account separate from any other account established and maintained under the Indenture designated as the Rebate Account. All money at any time deposited in the Rebate Account shall be held by the Trustee in trust, to the extent required to satisfy the rebate requirement (as provided to the Trustee in accordance with the Authority Tax Certificate), for payment to the federal government of the United States of America. Neither the Authority nor any Owners shall have any rights in or claim to such money.

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 shall be so invested as directed in an officer's certificate. Eligible Investments shall mature or be redeemable at the option of the Authority on or before the Business Day immediately preceding 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 Fund Installments described in paragraphs (b) (i) and (ii) under the caption "Application of Collections" on such next succeeding Distribution Dates. Investments and any income realized therefrom shall be held by the Trustee in the respective Accounts and shall 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 shall not be liable for any losses on investments made at the direction of the Authority.

Senior Liquidity Reserve Account. Except as provided elsewhere in the Indenture, any amounts in the Senior Liquidity Reserve Account in excess of the Senior Liquidity Reserve Requirement shall be applied as described in "Application of Collections". If after receipt of any Collections, the Trustee determines that a withdrawal from the Senior Liquidity Reserve Account will be required on December 1 of any year, the Trustee shall notify the provider under any forward purchase agreement at least 10 Business Days prior to the Business Day next preceding June 1 of such year, of the amount of money in the Senior Liquidity Reserve Account that must be invested in securities maturing prior to such December 1.

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 or Accreted Value of, or interest or premium, if any, on any Bond remains unclaimed for two years after such principal or Accreted Value, interest, or premium has become due and payable, the Fiduciary shall pay over to the Authority the amount so deposited and thereupon the Fiduciary shall be released from all liability under the Indenture with respect to the payment of principal or Accreted Value, interest, or premium and the Owner of such Bond shall be entitled (subject to any applicable statute of limitations) to look only to the Authority as an unsecured creditor for the payment thereof.

Contract; Obligations to Owners; Representations of the Authority

In consideration of the purchase and acceptance of any or all of the Bonds by those who shall hold the same from time to time, the provisions of the Indenture shall be a part of the contract of the Authority with the Owners. The pledge and grant of a security interest made in the Indenture and the covenants set forth in the Indenture to be performed by the Authority shall be for the equal benefit, protection, and security of the Owners. All of the Bonds of the same priority, regardless of the time or times of their maturity, shall be of equal rank without preference, priority, or distinction of any thereof over any other except as expressly provided pursuant to the Indenture.

The Authority covenants to pay when due all sums payable on the Bonds, but only from the Collateral and subject to the limitations set forth in the Indenture. The obligation of the Authority to pay principal or Accreted Value, interest, and redemption premium, if any, to the Owners shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment, or counterclaim.

The Authority represents and warrants that (i) it is duly authorized pursuant to 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 hereof, shall be valid and enforceable obligations of the Authority in accordance with their terms; (iv) it has not heretofore conveyed, assigned, pledged, granted a security interest in, or otherwise disposed of the Collateral except for the benefit of the defeased 2001 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 Authority in connection with the issuance of the Bonds.

The Indenture creates a valid pledge of the Collateral in favor of the Trustee as security for the payment of the Bonds, enforceable by the Trustee in accordance with the terms thereof.

The Authority has not heretofore made a pledge of, granted a lien on or security interest in, or made an assignment or sale of the Collateral that ranks on a parity with or prior to the security interest granted by the Indenture except for the benefit of the defeased 2001 Bonds. The Authority shall not hereafter make or suffer to exist any pledge or assignment of, lien on, or security interest in the Collateral that ranks prior to or on a parity with the pledge and security interest granted by the Indenture.

Operating Expenses

Covenant to Pay. The Authority shall 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 shall be made only from the Operating Contingency Account.

Officer's Certificate with respect to Operating Expenses. On the Closing Date, the Authority shall deliver to the Trustee an Officer's Certificate setting forth the Operating Expenses and the Tax Obligations that have been incurred by the Authority prior to such date and estimating the Operating Expenses and the Tax Obligations that will be incurred by the Authority to and including June 30, 2007. Thereafter, on or before April 1 of each year during which Bonds are Outstanding (beginning April 1, 2007 for the Fiscal Year ending June 30, 2008), the Authority shall deliver an Officer's Certificate to the Trustee estimating the Operating Expenses and the Tax Obligations that will be incurred or paid by the Authority during the next succeeding Fiscal Year. The Officer's Certificate may also set forth Operating Expenses that have already been incurred by the Authority but that have not yet been repaid, provided that the Operating Cap shall nonetheless continue to apply to all such amounts. The Authority may at any time submit a supplemental Officer's Certificate setting forth Operating Expenses in excess of the Operating Cap. Such excess shall be deposited in the Operating Contingency Account pursuant to the Indenture if, but only if, all of the deposits required by the Indenture have been fully funded. In the event that the Authority fails to deliver an Officer's Certificate on or prior to any April 1, the Authority shall be deemed to have delivered an Officer's Certificate certifying that the amount of the Operating Expenses and the Tax Obligations for the next Fiscal Year shall be the same as in the then-current Fiscal Year.

Tax Covenants

The Authority shall at all times do and perform all acts and things permitted by law and the Indenture which are necessary or desirable in order to assure that interest paid on the Tax-Exempt Bonds will be excluded from gross income for federal income tax purposes and shall 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 Authority agrees that it will comply with the provisions of the Authority Tax Certificate. This covenant shall survive defeasance or redemption of the Tax-Exempt Bonds.

Accounts and Reports and Swap Contract Information

The Authority shall (1) instruct the Trustee to keep books of account in which complete and accurate entries shall be made of its transactions relating to all funds and accounts under the Indenture, which books shall at all reasonable times be subject to the inspection of the Owners of an aggregate of not less than 25% in Bond Obligation 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 Authority shall further report to the Rating Agencies on an annual basis, but only to the extent that such information is not included in the Authority's financial statements, (a) the amounts and, to the extent available, the types of payments constituting TSRs that were received during the preceding 12-month period, and (b) whether, to the knowledge of the Authority, any litigation is then pending against the State, the County, the Corporation or the Authority seeking to invalidate or overturn the MSA, MOU, ARIMOU, the Purchase and Sale Agreement or the proceedings pursuant to which the Bonds are issued.

The Authority shall provide to the Trustee copies of all Swap Contracts and related information and schedules of payments under the Indenture as the Trustee may reasonably request for it to perform its duties under the Indenture

Ratings

The Authority shall pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Bonds from the number of nationally recognized securities rating services which rated the Bonds of a given Maturity Date of a given Series on the date of issuance thereof.

Affirmative Covenants

Maintenance of Existence. The Authority shall keep in full effect its corporate existence and all of its rights and powers.

Protection of Collateral. The Authority shall from time to time authorize, execute or authenticate, deliver and file all documents and instruments, and will take such other action, as is necessary or advisable to: (1) maintain or preserve the lien, pledge and security interest of the Indenture; (2) perfect or protect the validity of any grant made or to be made by the Indenture; (3) 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 MOU, the ARIMOU, the Basic Documents or the performance by any party thereunder; (4) enforce the Loan Agreement and the Purchase and Sale Agreement; (5) pay any and all taxes levied or assessed upon all or any part of the Collateral; or (6) carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Authority (1) shall diligently pursue any and all actions to enforce its rights in the Collateral and under each instrument or agreement included therein, and (2) shall 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 Basic Documents, the MOU and the ARIMOU.

Notice of Events of Default. The Authority shall give the Trustee and Rating Agencies prompt Written Notice of each Event of Default that is known to the Authority.

Other. The Authority shall:

(i) conduct its own business in its own name and not in the name of any other Person and correct any known misunderstanding regarding its separate identity;

(ii) maintain or contract for a sufficient number of employees and compensate all employees, consultants and agents directly, from the Authority's bank accounts, for services provided to the Authority by such employees, consultants and agents and, to the extent any employee, consultant or agent of the Authority is also an employee, consultant or agent of another Person, allocate the compensation of such employee, consultant or agent between the Authority and such Person on a basis that reflects the services rendered to the Authority and such Person;

(iii) have a separate telephone number, which will be answered only in its name and separate stationery, invoices and checks in its own name;

(iv) conduct all transactions with any other Person strictly on an arm's-length basis, allocate all overhead expenses (including, without limitation, telephone and other utility charges) for items shared between the Authority and such Person on the basis of actual use to the extent practicable and, to the extent such allocation is not practicable, on a basis reasonably related to actual use;

(v) at all times have a Board of Directors consisting of at least three members;

(vi) observe all formalities as a distinct entity, and ensure that all actions relating to (1) the dissolution or liquidation of the Authority or (2) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Authority, are duly authorized by unanimous vote of its Board of Directors;

(vii) 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 not commingle its assets with those of any other Person;

(viii) maintain its own separate records and accounts, and prepare financial statements in accordance with generally accepted accounting principles, consistently applied, and susceptible to audit; to the extent it is included in consolidated financial statements or consolidated tax returns, such financial statements and tax returns will make clear the separateness of the respective entities and make clear that the assets of the Authority are not assets of any other Person and are not available to satisfy the debts of any other Person;

(ix) only maintain bank accounts or other depository accounts to which the Authority alone is the account party, and from which only the Authority or the Trustee has the power to make withdrawals;

(x) pay all of the Authority's operating expenses from the Authority's own assets (except for expenses incurred prior to the date of issuance of the Bonds);

(xi) 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 Basic Documents; and does not create, incur, guarantee, assume or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (1) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (2) the incurrence of obligations contemplated and authorized by the Basic Documents, and (3) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Basic Documents;

Negative Covenants

Sale of Assets. Except as expressly permitted by the Indenture, the Authority shall not sell, transfer, exchange, or otherwise dispose of any of its properties or assets that are subject to the lien of the Indenture.

Termination. The Authority shall not terminate its existence or engage in any action that would result in the termination of the Authority.

Limitation of Liens. The Authority shall not (1) 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, (2) 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 (3) permit the security interest created by the Indenture not to constitute a valid first priority security interest in the Collateral.

Payments Restricted. The Authority shall not, directly or indirectly, make distributions from the Collections Account except in accordance with the Indenture.

No Setoff. The Authority will not claim any credit on, or make any deductions from the principal or Accreted Value 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 Authority will not consolidate or merge with or into any other Person, or convey or transfer all or substantially all of its properties or assets, or be succeeded by any other person, unless:

(i) the person surviving such consolidation or merger (if other than the Authority), 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 or Accreted Value of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of the Authority in the Indenture;

(ii) immediately after giving effect to such transaction, no Event of Default has occurred and is continuing under the Indenture;

(iii) the Authority has received a Rating Confirmation with respect to any Outstanding Bonds which are then rated by a Rating Agency;

(iv) the Authority has received an opinion of Counsel to the effect that such transaction will not have material adverse tax consequences to the Authority and will not, in and of itself, cause interest on any Tax-Exempt Bonds to be included in gross income for federal income tax purposes;

(v) any action as is necessary to maintain the security interest created by the Indenture has been taken; and

(vi) the Authority has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

(g) Swap Contracts. The Authority shall not enter into any Swap Contract until it has first obtained a Rating Confirmation with respect to all Outstanding Bonds which are then rated by a Rating Agency with respect to such Swap Contract, nor shall it enter into any Swap Contract unless such Swap Contract provides that any payments to be made to or for the benefit of the Authority shall be made to the Trustee for deposit into the Collections Account.

Continuing Disclosure Undertaking

If (and to the extent that) (x) a Series of Bonds is purchased from the Authority by a broker, dealer or municipal securities dealer (each a "Dealer") subject to Rule 15c2-12 (the "Rule") of the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "1934 Act"), (y) the Rule requires Dealers to determine, as a condition to purchasing such Bonds, that the Authority will covenant to the effect

of the Indenture, and (z) the Rule as so applied is authorized by federal law that as so construed is within the powers of Congress, then the Authority covenants, for the sole benefit of the Owners (and, to the extent specified in the provisions of the Indenture relating to continuing disclosure, the beneficial owners) of the Outstanding Bonds of each such Series and subject (except to the extent otherwise expressly provided in the Indenture) to the remedial provisions of the Indenture, that:

(a) The Authority shall provide:

(i) 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,

(A) 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,

(B) an update of operating data for the preceding Fiscal Year set forth under the last three columns titled "Total Payments" in the table captioned "Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Trustee" in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" in the Offering Circular, and

(C) 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 – Series 2006 Senior Bonds' Debt Service Coverage" in the Offering Circular; and

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

(A) principal and interest payment delinquencies;

(B) non-payment related Defaults;

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

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

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

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

(G) modifications to rights of Owners;

(H) bond calls;

(I) defeasances;

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

(K) rating changes; and

(L) failure to comply with the provisions of the Indenture relating to continuing disclosure.

(b) The Authority does not undertake to provide such notice with respect to:

(i) credit enhancement if

(A) the enhancement is added after the primary offering of the Bonds,

(B) the Authority does not apply for or participate in obtaining the enhancement and

(C) the enhancement is not described in the applicable official statement or offering circular of the Authority;

(ii) a mandatory, scheduled redemption, not otherwise contingent upon the occurrence of an event, if

(A) the terms, dates and amounts of redemption are set forth in detail in the Offering Circular,

(B) the only open issue is which Bonds will be redeemed in the case of a partial redemption,

(C) notice of redemption is given to the Owners as required under the terms of the Indenture and

(D) public notice of the redemption is given pursuant to Release No. 23856 of the SEC under the 1934 Act, even if the originally scheduled amounts may be reduced by prior optional redemptions or purchases; or

(iii) tax exemption other than pursuant to Section 103 of the Code; or

(iv) any forward-looking statements contained in the Offering Circular, including but not limited to those that include the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes," or analogous expressions.

(c) In addition to the Trustee's and Owners' remedies specified in the Indenture, any beneficial owner of Bonds of a Series described in the provisions of the Indenture relating to continuing disclosure may institute a suit, action or proceeding at law or in equity (a "Proceeding") to enforce the undertaking set forth in the provisions of the Indenture relating to continuing disclosure (the "Undertaking") or for any remedy for breach thereof without acting in concert if:

(i) such owner shall have filed with the Authority:

(A) evidence of beneficial ownership and

(B) written notice of, and request to cure, the alleged breach,

(ii) the Authority shall have failed to comply within a reasonable time, and

(iii) such beneficial owner stipulates that:

(A) no challenge is made to the adequacy of any information provided in accordance with the Undertaking and

(B) no remedy is sought other than substantial performance of the Undertaking. To the extent permitted by law, each beneficial owner agrees that all Proceedings shall be instituted only as specified herein in the federal or state courts located in the State, and for the equal benefit of all such owners of the Outstanding Bonds benefited by the same or a substantially similar undertaking.

(d) For the purposes of the provisions of the Indenture relating to continuing disclosure, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such security, except that a person who in the ordinary course of business is a pledgee of securities under a written pledge agreement shall not be deemed to be the beneficial owner of such pledged securities until the pledgee has taken all formal steps to declare a default and determines that the power to dispose or to direct the disposition of such pledged securities will be exercised, provided that:

(i) the pledge agreement is bona fide;

(ii) the pledgee is:

(A) a broker or dealer registered under Section 15 of the 1934 Act;

(B) a bank as defined in Section 3(a)(6) of the 1934 Act;

(C) an insurance company as defined in Section 3(a)(19) of the 1934 Act;

(D) an investment company registered under Section 8 of the Investment Company Act of 1940;

(E) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940;

(F) an employee benefit plan, or pension fund which is subject to the provisions of the Employee Retirement Income Security Act of 1974 or an endowment fund;

(G) a parent holding company, provided the aggregate amount held directly by the parent, and directly and indirectly by its subsidiaries which are not persons specified in items (A) through (F) of this clause (ii) does not exceed 1% of the securities of the subject class; or

(iii) a group, provided that all the members are persons specified in items (A) through (G) of this clause (ii); and

(iv) the pledge agreement, prior to default, does not grant to the pledgee the power to dispose or direct the disposition of the pledged securities, other than the grant of such power(s) pursuant to a pledge agreement under which credit is extended subject to Regulation T (12 CFR 220.1 to 220.8) and in which the pledgee is a broker or dealer registered under Section 15 of the 1934 Act.

(e) Any Supplemental Indenture amending the Undertaking may only be entered into:

(i) if all or any part of the Rule, as interpreted by the staff of the SEC at the date hereof, ceases to be in effect for any reason and the Authority elects that this Undertaking shall be deemed terminated or amended (as the case may be) accordingly, or

(ii) if (A) amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Authority, or type of business conducted,

(B) the Undertaking, as amended, would have complied with the requirements of the Rule at the date hereof, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances,

(C) the amendment does not materially impair the interests of the Owners of each affected Series, as determined by parties unaffiliated with the Authority (such as, but without limitation, the Authority's financial advisor or bond counsel) or by Owner consent pursuant to the Indenture, and

(D) 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 staff of the SEC 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.

(f) The Trustee agrees to serve as dissemination agent for the Authority for purposes of transmitting filings pursuant to the continuing disclosure undertakings set forth in the provisions of the Indenture relating to continuing disclosure provided to the Trustee by the Authority for such purpose until the Authority appoints another agent or assumes such role itself.

(g) Any filing under the provisions of the Indenture relating to continuing disclosure may be made solely by transmitting such filing to the Texas Municipal Advisory Council (the "MAC") as provided at www.DisclosureUSA.org <http://www.DisclosureUSA.org> unless the Securities and Exchange Commission has withdrawn the interpretive advise in its letter to the MAC dated September 7, 2004.

Reports by Trustee to Owners and Rating Agency

The Trustee shall deliver to each Rating Agency, the Authority 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 Authority setting forth: (i) the Outstanding Bonds on such Distribution Date; (ii) the amount of interest to be paid to Owners on such Distribution Date; (iii) 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; (iv) 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 (v) whether the amount on deposit in the Senior Liquidity Reserve Account is sufficient to satisfy the Senior 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 (including in its individual capacity), beneficial owner or Owner shall, 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 Authority or the Corporation to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against the Authority or 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 Authority or the Corporation or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Authority or the Corporation.

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, shall be sufficient for any purpose of the Indenture (except as otherwise in the Indenture expressly provided) if made in the following manner, but the Authority or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any 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 shall be irrevocable and bind all future record and beneficial owners thereof.

Registered Owners

The enumeration in the Indenture of certain provisions applicable to DTC as Owner of immobilized Bonds shall not be construed in limitation of the rights of the Authority and each Fiduciary to rely upon the registration books in all circumstances and to treat the 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 Owner of a Bond shall satisfy the Authority's obligations thereon to the extent of such payment.

Events of Default

"Event of Default" in the Indenture means any one of the events set forth below:

(a) failure to pay when due any Swap Payment or interest on any Senior Bonds;

(b) failure to pay when due any Serial Maturity or Turbo Term Bond Maturity for Senior Bonds; or

(c) failure of the Authority to observe or perform any other covenant, condition, agreement, or provision contained in the Senior Bonds or in the Indenture relating to Senior Bonds, which breach is not remedied within 60 days after Written Notice, specifying such default and requiring the same to be remedied, shall have been given to the Authority by the Trustee or by the Owners of at least 25% in Bond Obligation of the Senior Bonds then Outstanding. In the case of a default specified in this subsection, if the default be such that it cannot be corrected within the said 60-day period, it shall not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the default is corrected.

Except as specified in subsections (a) and (b) above, failure to make any payment or to make provision therefor, including 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 to make such payment or provision therefor.

Notwithstanding anything in the Indenture to the contrary, a Subordinate Payment Default is not an Event of Default under the Indenture, provided that in the event of a Subordinate Payment Default, Owners of First Subordinate Bonds, Second Subordinate Bonds and Additional Subordinate Bonds shall have the remedies described in the paragraph entitled "Remedies for First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds" of the section "Remedies" below.

Remedies

Remedies of the Trustee. If an Event of Default occurs:

The Trustee may, and upon written request of the Owners of at least 25% in Bond Obligation of the Senior Bonds Outstanding shall, in its own name by action or proceeding in accordance with law: (i) enforce all rights of the Owners and require the Authority to carry out its agreements under the Bonds, the Indenture or the Loan Agreement; (ii) sue upon such Bonds; (iii) require the Authority to account as if it were the trustee of an express trust for such Owners; and (iv) enjoin any acts or things which may be unlawful or in violation of the rights of such Owners.

Upon an Event of Default described under section (a) or (b) of the section "Indenture – Events of Default", or a failure to make any other payment required under the Indenture within 7 days after the same becomes due and payable, the Trustee shall give Written Notice thereof to the Authority. The Trustee shall give notice when instructed to do so by the written direction of another Fiduciary or the Owners of at least 25% in Bond Obligation of the Outstanding Senior Bonds. Upon the occurrence of an Event of Default, the Trustee shall proceed for the benefit of the Owners in accordance with the written direction of a Majority in Interest of the Outstanding Senior Bonds. The Trustee shall not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of Written Notice, direction, and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any Event of Default of which it is notified as aforesaid, the Trustee shall promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Owners, and shall act for the protection of the Owners with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Upon the occurrence of an Event of Default, the Bonds and Swap Payments shall be paid as described in paragraph (d) under the caption "Application of Collections".

Remedies for First Subordinate Bonds, Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds. Only if the Senior Bonds are no longer Outstanding, the Owners of First Subordinate Bonds, the Second Subordinate Bonds, Third Subordinate Bonds and Additional Subordinate Bonds may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings in accordance with clauses (3) - (5) of the definition of Payment Priorities.

(1) The principal or Accreted Value, premium, if any, and interest on First Subordinate Bonds will be subordinated in right of payment to principal or Accreted Value, premium, if any, and interest payments on the Senior Bonds. If any Event of Default shall have occurred and be continuing, Owners of Senior Bonds will be entitled to receive payment thereof in full before the Owners of the First Subordinate Bonds are entitled to receive payment thereof; and any payment or distribution of assets otherwise payable to Owners of the First Subordinate Bonds will be paid to Owners of Senior Bonds until all Senior Bonds have been paid in full, and the Owners of the First Subordinate Bonds will be subrogated to the rights of such Owners of Senior Bonds to receive payments or distributions of assets with respect thereto.

(2) The principal or Accreted Value, premium, if any, and interest on Second Subordinate Bonds will be subordinated in right of payment to principal or Accreted Value, premium, if any, and interest payments on the First Subordinate Bonds. If any Subordinate Payment Default shall have occurred and be continuing, Owners of First Subordinate Bonds will be entitled to receive payment thereof in full before the Owners of the Second Subordinate Bonds are entitled to receive payment thereof; and any payment or distribution of assets otherwise payable to Owners of the Second Subordinate Bonds will be paid to Owners of First Subordinate Bonds until all First Subordinate Bonds have been paid in full, and the Owners of the Second Subordinate Bonds will be subrogated to the rights of such Owners of First Subordinate Bonds to receive payments or distributions of assets with respect thereto.

(3) The principal or Accreted Value, premium, if any, and interest on Third Subordinate Bonds will be subordinated in right of payment to principal or Accreted Value, premium, if any, and interest payments on the Second Subordinate Bonds. If any Subordinate Payment Default shall have occurred and be continuing, Owners of Second Subordinate Bonds will be entitled to receive payment thereof in full before the Owners of the Third Subordinate Bonds are entitled to receive payment thereof; and any payment or distribution of assets otherwise payable to Owners of the Third Subordinate Bonds will be paid to Owners of Second Subordinate Bonds until all Second Subordinate Bonds have been paid in full, and the Owners of the Third Subordinate Bonds will be subrogated to the rights of such Owners of Second Subordinate Bonds to receive payments or distributions of assets with respect thereto.

(4) The principal or Accreted Value, premium, if any, and interest on Additional Subordinate Bonds will be subordinated in right of payment to principal or Accreted Value, premium, if any, and interest payments on the Third Subordinate Bonds. If any Subordinate Payment Default shall have

occurred and be continuing, Owners of Third Subordinate Bonds will be entitled to receive payment thereof in full before the Owners of the Additional Subordinate Bonds are entitled to receive payment thereof; and any payment or distribution of assets otherwise payable to Owners of the Additional Subordinate Bonds will be paid to Owners of Third Subordinate Bonds until all Third Subordinate Bonds have been paid in full, and the Owners of the Additional Subordinate Bonds will be subrogated to the rights of such Owners of Third Subordinate Bonds to receive payments or distributions of assets with respect thereto.

Individual Remedies. No one or more Owners shall 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 in the Indenture provided, and all proceedings at law or in equity to enforce any provision of the Indenture shall be instituted, had, and maintained in the manner provided in the Indenture and for the equal benefit of all Owners of the same class, but nothing in the Indenture shall affect or impair the right of any Owner to enforce payment of the principal or Accreted Value of, premium, if any, or interest thereon at and after the same comes due pursuant to the Indenture, or the obligation of the Authority to pay such principal or Accreted Value, 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. To the extent permitted by law, the venue of every action, suit, or special proceeding against the Authority shall be laid in federal or state courts located in San Diego, California, unless waived by the Authority.

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 Authority, and shall do so upon written instruction of the Owners of at least 25% in Bond Obligation of the Outstanding Senior Bonds.

No Sale of Rights or Foreclosure. Neither the Indenture Trustee nor the Bondholders shall have the right to sell or foreclose on the Collateral or the rights of the Corporation under the Loan Agreement

Remedies Cumulative

The rights and remedies under the Indenture shall be cumulative and shall not exclude any other rights and remedies allowed by law, provided there is no duplication of recovery. The failure to insist upon a strict performance of any of the obligations of the Authority or to exercise any remedy for any violation thereof shall not be taken as a waiver for the future of the right to insist upon strict performance by the Authority or of the right to exercise any remedy for the violation.

Delay or Omission Not Waiver

No delay or omission of the Trustee or of any Owner to exercise any right or remedy accruing upon any Event of Default shall 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 by 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.

Supplements and Amendments to the Indenture

The Indenture may be: (i) supplemented or amended in writing by the Authority and the Trustee to (a) provide for earlier or greater deposits into the Senior Debt Service Account, (b) subject any property to the security interest created (c) add to the covenants and agreements of the Authority or surrender or limit any right or power of the Authority, (d) 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, (e) cure any ambiguity or defect, (f) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939,

as amended, (g) make any other changes to the Indenture that, as evidenced by a Rating Confirmation with respect to any Outstanding Bonds which are then rated by a Rating Agency, are not materially adverse to the Owners of Outstanding Bonds, or (h) provide for the issuance of the Series 2006 Bonds, Additional Bonds and Additional Subordinate Bonds; or (ii) amended in writing by the Authority and the Trustee, (a) to add provisions that are not adverse to the Owners, (b) to 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, or (c) pursuant to the following paragraph.

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 each Series of 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 Date of any Bond, (b) to reduce the principal amount, Accreted Value, 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 Bond Obligation of the Bonds required to be represented by the Owners giving their consent to any amendment.

LOAN AGREEMENT

The Loan Agreement provides the terms of the loan of the Bond proceeds to the Corporation by the Authority and the repayment and security for the loan by the Corporation. Certain of the provisions of the Loan Agreement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Loan Agreement.

Issuance of Bonds; Deposit of Proceeds

Pursuant to the Indenture, the Authority has authorized the issuance of the Bonds in the aggregate principal amount set forth therein. Pursuant to the Loan Agreement, the Authority loans and advances to the Corporation, and the Corporation by Loan Agreement borrows and accepts from the Authority a loan of the proceeds of the Bonds to be applied under the terms and conditions of the Loan Agreement to provide funds to assist the Corporation in refinancing the acquisition of the County Tobacco Assets (the "Loan"). Pursuant to the Loan Agreement, the Corporation approves the Indenture and the assignment under the Indenture to the Trustee of the right, title and interest of the Authority in the Loan Agreement.

If the Corporation is not in default hereunder, the Authority may by the adoption of an appropriate resolution or resolutions, at the request of the Corporation, authorize the issuance of Additional Bonds and Additional Subordinate Bonds upon the terms and conditions provided in the Indenture.

Amounts Payable

In consideration of the Loan to the Corporation, the Corporation agrees that, as long as any of the Bonds remain Outstanding under the Indenture, it shall pay or cause to be paid to the Trustee for deposit in the Collections Account established under the Indenture all Tobacco Settlement Revenues when and as such are received. Each payment by the Corporation to the Trustee under the Loan Agreement (the "Loan Payments") shall be in lawful money of the United States of America and paid to the Trustee at its Corporate Trust Office. Except as otherwise expressly provided in the Loan Agreement, all amounts payable under the Loan Agreement by the Corporation to the Authority shall be paid to the Trustee as assignee of the Authority.

The Corporation will also pay (from the Tobacco Settlement Revenues deposited by the Trustee in the Operating Account or Operating Contingency Account under the Indenture) all fees and expenses of the Trustee and the Authority in connection with the Loan and the Bonds, including, without limitation, legal fees and expenses incurred in connection with any redemption of Bonds or in connection with the interpretation, enforcement or amendment of any documents relating to the Loan, the Corporation Tobacco Assets or the Bonds, as and when such amounts become due and payable; provided, that in each case, to the extent amounts in the Operating Account or the Operating Contingency Account under the Indenture are insufficient to make any such payments, the Corporation shall not be required to make such payments until such time as amounts are available for such purpose in the Operating Account or the Operating Contingency Account under the Indenture.

In order to ensure payment of the amounts described above, the Corporation shall cause the County to give to the Attorney General of the State the instructions described in the Loan Agreement.

In the event the Corporation fails to make any of the payments required in this section, the item or installment not so paid shall continue as an obligation of the Corporation until the amount not so paid shall have been fully paid.

Obligations Unconditional; Limited Recourse

The obligations of the Corporation to make the payments required in the Loan Agreement and to perform and observe the other agreements contained therein shall be absolute and unconditional and shall not be subject to any defense or any right of setoff, counterclaim or recoupment arising out of any breach by the Authority or the Trustee of any obligation to the Corporation, or out of any indebtedness or liability at any time owing to the Corporation by the Authority or the Trustee, and until such time as the principal of, redemption premium, if any, and interest on the Bonds shall have been fully paid or provision for the payment thereof shall have been made in accordance with the Indenture, the Corporation (a) will not suspend or discontinue any payments provided for in the Loan Agreement, (b) will perform and observe all other agreements contained in the Loan Agreement, and (c) will not terminate the Loan Agreement for any cause, including, without limiting the generality of the foregoing, the occurrence of any acts or circumstances that may constitute failure of consideration, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Authority or the Trustee to perform and observe any agreement, whether express or implied, or any duty, liability or obligation arising out of or connected with the Loan Agreement. Nothing contained in this section shall be construed to release the Authority from the performance of any of the agreements on its part contained in the Loan Agreement, and in the event the Authority or the Trustee fails to perform any such agreement on its part, the Corporation may institute such action against the Authority or the Trustee as the Corporation may deem necessary to compel performance so long as such action does not abrogate the obligations of the Corporation contained in the first sentence of this paragraph.

Notwithstanding the foregoing or any other provision or obligation to the contrary contained in the Loan Agreement or any other Basic Document, the liability of the Corporation under the Loan Agreement and the other Basic Documents to any Person, including, but not limited to, the Trustee or the Authority and their successors and assigns, is limited to the Corporation's interest in the Corporation Tobacco Assets, and the amounts held in the funds and accounts created under the Indenture, and such Persons shall look exclusively thereto, or to such other security as may from time to time be given for the payment of obligations arising out of the Loan Agreement or any other agreement securing the obligations of the Corporation under the Loan Agreement.

Grant of Security Interest

As security for the Loan and any obligations related thereto, the Corporation pledges and assigns to the Authority and grants to the Authority a first priority perfected security interest in all right, title and interest of the Corporation, in, to and under the following property (collectively and severally, the "Corporation Tobacco Assets"): (i) the County Tobacco Assets (as defined in the Purchase and Sale Agreement, the "County Tobacco Assets") purchased from the County; (ii) to the extent permitted by law (as to which no representation is made), corresponding present or future rights, if any, of the Corporation to enforce or cause the enforcement of payment of such purchased County Tobacco Assets pursuant to the MOU and the ARIMOU; (iii) the corresponding rights of the Corporation under the Purchase and Sale Agreement; and (iv) all proceeds of any and all of the foregoing.

Conditions Precedent

The obligation of the Authority to make the Loan on the Closing Date is subject to the conditions that:

(a) The representations and warranties of the Corporation set forth in the Loan Agreement are true and correct in all material respects;

(b) All agreements relating to the transactions contemplated by the Loan Agreement are in form and substance satisfactory to the Authority and the Corporation; and

(c) The Corporation shall have given or caused to be given instructions to the Attorney General of the State pursuant to Sections 4.B.(2)(i)(aa) and 4.B.(2)(i)(bb) of the ARIMOU to cause the California Escrow Agent to disburse all moneys received on account of the Corporation Tobacco Assets from the California Escrow to the Trustee, together with an acknowledgement that such instructions shall only be further modified with the countersignature of a designated representative of the Trustee until the Trustee gives notice to the Attorney General of the State that there are no longer any Bonds Outstanding under the Indenture, after which any further modification must be countersigned by a representative of the Corporation.

Waiver and Satisfaction of Conditions Precedent

The Authority, by making the Loan under the Loan Agreement, either waives or acknowledges satisfaction of the conditions precedent set forth in the Loan Agreement.

Representations and Warranties of the Corporation

In order to induce the Authority to enter into the Loan Agreement, the Corporation represents and warrants to the Authority as follows:

(a) The Corporation is validly existing as a nonprofit public benefit corporation under the laws of the State, with full power and authority to execute and deliver the Loan Agreement and the Purchase and Sale Agreement and to carry out their terms.

(b) The Corporation has full power, authority and legal right to grant a security interest in the Corporation Tobacco Assets to the Authority and has duly authorized such grant of security interest to the Authority by all necessary action; and the execution, delivery and performance by the Corporation of the Loan Agreement and the Purchase and Sale Agreement have been duly authorized by the Corporation by all necessary action.

(c) The Loan Agreement and the Purchase and Sale Agreement have been duly executed and delivered by the Corporation and, assuming the due authorization, execution and delivery of each such agreement by the other parties thereto, constitute legal, valid and binding obligations of the Corporation enforceable in accordance with their terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

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

(e) The consummation by the Corporation of the transactions contemplated by the Loan Agreement and the Purchase and Sale Agreement and the fulfillment by the Corporation of the terms thereof do not in any material way conflict with, result in any breach by the Corporation of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a default by the Corporation under any indenture, agreement or other instrument to which the Corporation is a party or by which it is bound; nor violate any

law, order, rule or regulation applicable to the Corporation of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Corporation.

(f) There are no proceedings or investigations pending against the Corporation, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Corporation: (i) asserting the invalidity of the Loan Agreement or the Purchase and Sale Agreement, or, to the best of its knowledge, the Indenture or the Bonds, (ii) seeking to prevent the consummation of any of the transactions contemplated by the Loan Agreement or the Purchase and Sale Agreement, or, to the best of its knowledge, the Indenture or the Bonds, or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of the Loan Agreement or the Purchase and Sale Agreement, or, to the best of its knowledge, the Indenture or the Bonds.

(g) Based on the representations and warranties of the County under the Purchase and Sale Agreement, except to the extent that the State has the right to reallocate moneys paid under the MOU and the ARIMOU, as provided in the MOU and the ARIMOU, the Corporation holds title to the Corporation Tobacco Assets free and clear and without liens thereon, other than the lien of the Loan Agreement and the lien of the Indenture. The Corporation has not sold, transferred, assigned, pledged, granted a security interest in, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Corporation Tobacco Assets (except in connection with the defeased 2001 Bonds), nor has the Corporation (except in connection with the defeased 2001 Bonds) created or permitted the creation of, any lien thereon, other than the lien of the Loan Agreement and the lien of the Indenture.

(h) The Loan Agreement creates a valid and continuing security interest (as defined in the applicable UCC) in the Corporation Tobacco Assets in favor of the Authority, which security interest is prior to all other liens, and is enforceable as such as against creditors of and purchasers from the Corporation.

(i) The Corporation Tobacco Assets constitute "accounts" or "general intangibles" within the meaning of the applicable UCC.

(j) The Corporation has caused or will have caused, within ten days, the filing of all appropriate financing statements in the proper filing office in the appropriate jurisdictions under applicable law in order to perfect the security interest in the Corporation Tobacco Assets granted to the Authority hereunder.

(k) The Corporation has not authorized the filing of and is not aware of any financing statements against the Corporation that include a description of collateral covering the Corporation Tobacco Assets other than any financing statement relating to the security interest granted to the Authority hereunder and other than the financing statement in connection with the defeased 2001 Bonds, which is being terminated contemporaneously with the execution and delivery of the Loan Agreement. The Corporation is not aware of any judgment or tax lien filings against the Corporation.

(l) The Corporation has received all consents and approvals required by the terms of the Corporation Tobacco Assets to the grant of security interest in the Corporation Tobacco Assets hereunder to the Authority.

Representations and Warranties of the Authority

In order to induce the Corporation to enter into the Loan Agreement, the Authority represents and warrants to the Corporation as follows:

(a) The Authority is a joint powers authority duly organized and validly existing under the laws of the State. Pursuant to resolutions duly adopted by the Board of Directors of the Authority, the Authority has authorized the execution and delivery of the Loan Agreement and the other Basic Documents to which it is a party, and the performance by the Authority of all of its obligations hereunder and under the other Basic Documents to which it is a party.

(b) The Authority has complied with all of the provisions of the laws of the State relating to the Basic Documents, and has full power and authority to consummate all transactions contemplated by the Bonds, the Basic Documents and any and all other agreements relating thereto, and to perform all of its obligations hereunder and thereunder.

(c) The Authority has not pledged and covenants that it will not pledge the amounts derived from the Loan Agreement and the Corporation Tobacco Assets other than to secure the Bonds.

(d) The Authority will duly file Internal Revenue Form 8038-G, which shall contain the information required to be filed pursuant to Section 149 of the Code.

Covenants and Agreement of the Corporation

Until the termination of the Loan Agreement and the satisfaction in full by the Corporation of all obligations hereunder, the Corporation shall comply, and shall cause compliance, with the following affirmative covenants:

Preservation of Rights. The Corporation shall take all actions as may be required by law to fully preserve, maintain, defend, protect and confirm the interests of the Authority and the interests of the Trustee in the Corporation Tobacco Assets. The Corporation shall not take any action that shall adversely affect the Authority's or the Trustee's ability to receive payments made under the MOU, the ARIMOU, the MSA and the Consent Decree.

No Impairment. The Corporation shall not limit or alter the rights of the Authority to fulfill the terms of its agreements with the Owners of the Bonds, or in any way impair the rights and remedies of such Owners or the security for the Bonds and shall enforce all of its rights under the Purchase and Sale Agreement, 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 Owners, are fully paid and discharged.

No Amendments to Collateral Documents. The Corporation shall not amend the Purchase and Sale Agreement, except as provided therein. The Corporation shall not take any action and shall 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 the MOU or the ARIMOU or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MOU or the ARIMOU, nor, without the prior written consent of the Authority and the Trustee, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the MOU or the ARIMOU, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Owners.

Further Acts. Upon request of the Authority or the Trustee, the Corporation shall authorize, execute and deliver all such further agreements, instruments, financing statements or other assurances as may be reasonably necessary to carry out the intention or to facilitate the performance of the Loan Agreement, including, without limitation, to perfect and continue the security interests created under the Loan Agreement.

Tax Covenant. The Corporation shall at all times do and perform all acts and things permitted by law which are necessary or desirable in order to assure that interest paid on the Tax-Exempt Bonds (or any of them) will be excluded from gross income for federal income tax purposes and shall take no action that would result in such interest not being excluded from gross income for federal income tax purposes.

Books and Records. The Corporation shall at all times keep proper books of record and account in which full, true and correct entries shall be made of its transactions in accordance with generally accepted accounting principles.

Change of Name or Type or Jurisdiction of Organization. The Corporation shall not change its name or its type or jurisdiction of organization without the consent of the Trustee.

Inspections. The Corporation shall permit any Person designated by the Authority, upon reasonable notice and during normal business hours, to visit and inspect any of the properties and offices of the Corporation, to examine the books and records of the Corporation and make copies thereof and to discuss the affairs, finances and business of the Corporation with, and to be advised as to the same by, their officers, auditors and accountants, all at such times and intervals as the Authority may reasonably request.

Use of Proceeds. The Corporation shall use the proceeds of the Loan only for the purposes set forth in the Loan Agreement.

Status as Special Purpose Entity. The Corporation shall: (1) conduct its own business in its own name and not in the name of any other Person; (2) compensate all employees, consultants and agents directly, from the Corporation's bank accounts, for services provided to the Corporation by such employees, consultants and agents and, to the extent any employee, consultant or agent of Corporation is also an employee, consultant or agent of any other Person, allocate the compensation of such employee, consultant or agent between the Corporation and such Person on a basis that reflects the services rendered to the Corporation and such Person; (3) have a separate telephone number, which will be answered only in its name and separate stationery, invoices and checks in its own name; (4) conduct all transactions with any other Person strictly on an arm's-length basis, allocate all overhead expenses (including, without limitation, telephone and other utility charges) for items shared between the Corporation and such Person on the basis of actual use to the extent practicable and, to the extent such allocation is not practicable, on a basis reasonably related to actual use; (5) at all times have a Board of Directors consisting of at least five members (including one Independent Director, as defined in the Corporation's articles of incorporation); (6) observe all corporate formalities as a distinct entity, and ensure that all corporate actions relating to (i) the dissolution or liquidation of the Corporation or (ii) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Corporation, are duly authorized by unanimous vote of its Board of Directors; (7) maintain the Corporation's books and records separate from those of any other Person and maintain its assets readily identifiable as its own assets rather than assets of the County; (8) maintain its own separate records and accounts, and prepare financial statements in accordance with generally accepted accounting principles, consistently applied, and susceptible to audit; to the extent it is included in consolidated financial statements or consolidated tax returns, such financial statements and tax returns will make clear the separateness of the respective entities and make clear that the assets of the Authority are not assets of any other Person and are not available to satisfy the debts of any other Person; (9) only maintain bank accounts or other depository accounts to which the Corporation alone is the account party, and from which only the Corporation has the power to make withdrawals; (10) pay all of the Corporation's operating expenses from the Corporation's own assets or pursuant to the Indenture (except for expenses incurred prior to the Closing Date); (11) 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 Basic Documents; and does not create, incur, guarantee, assume or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (i) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (ii) the incurrence of obligations contemplated and authorized by the Basic Documents, and (iii) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Basic Documents; (12) maintain its corporate organization in conformity with the Loan Agreement, such that it does not amend, restate, supplement or otherwise modify its articles of incorporation or bylaws in any respect that would impair its ability to comply with the terms or provisions of any of the Basic Documents; and (13) maintain its corporate separateness such that it does not merge or consolidate with or into, or convey, transfer, lease or otherwise dispose of (whether in one transaction or in a series of transactions, and except as otherwise contemplated in the Loan Agreement) all or substantially all of its assets to, or acquire all or substantially all of the assets of, any Person.

Filings. The Corporation, at the Corporation's expense, shall promptly procure, authorize, execute and deliver to the Authority all documents, instruments and agreements and perform all acts which are necessary or desirable, or which the Authority may reasonably request, to establish, maintain, continue, preserve, protect and perfect the grant of security interest in the Corporation Tobacco Assets, the lien granted to the Authority in the Loan Agreement and the first priority of such lien or to enable the Authority to exercise and enforce its rights and remedies under the Loan Agreement with respect to the grant of security interest in the Corporation Tobacco Assets. Without limiting the generality of the preceding sentence, the Corporation shall (i) procure, authorize, execute and deliver to the Authority all endorsements, assignments, financing statements and other instruments of transfer

requested by the Authority, (ii) deliver to the Authority promptly upon receipt all originals of Corporation Tobacco Assets consisting of instruments, documents, chattel paper, letters of credit and certificated securities and (iii) take or cause to be taken such actions as may be necessary to perfect the lien of Authority in any Corporation Tobacco Assets consisting of investment property.

No Modification of Escrow Instruction. So long as any Bonds are Outstanding under the Indenture, the Corporation shall not rescind, amend or modify the instruction described in the Loan Agreement without the consent of the Trustee.

Nonpetition Covenant By Corporation. The Corporation covenants and agrees that it will not at any time institute against the Authority, or join in instituting against the Authority, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

Bankruptcy. The Corporation shall object in any relevant bankruptcy case to the consolidation of the assets of the Corporation or the Authority with those of the County.

Non Petition Covenant By Authority

The Authority covenants and agrees that it will not at any time institute against the Corporation, or join in instituting against the Corporation, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

Events of Default

The occurrence or existence of any one or more of the following shall constitute an "Event of Default" under the Loan Agreement:

(a) The Corporation shall fail to pay or cause to be paid to the Trustee for deposit in the Collections Account established under the Indenture all Tobacco Settlement Revenues; or

(b) The Corporation shall fail to observe or perform any other covenant, obligation, condition or agreement contained in the Loan Agreement and such failure shall continue for 30 days from the date of written notice from the Authority or the Trustee of such failure; or

(c) Any representation, warranty, certificate, information or other statement (financial or otherwise) made or furnished by or on behalf of the Corporation to the Authority in or in connection with the Loan Agreement shall be false, incorrect, incomplete or misleading in any material respect when made or furnished; or

(d) The Corporation shall (i) apply for or consent to the appointment of a receiver, trustee, liquidator or custodian of itself or of all or a substantial part of its property, (ii) be unable, or admit in writing its inability, to pay its debts generally as they mature, (iii) make a general assignment for the benefit of its or any of its creditors, (iv) be dissolved or liquidated in full or in part, (v) become insolvent (as such term may be defined or interpreted under any applicable statute), (vi) commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law or consent to any such relief or to the appointment of or taking possession of its property by any official in an involuntary case or other proceeding commenced against it, or (vi) take any action for the purpose of effecting any of the foregoing; or

(e) Proceedings for the appointment of a receiver, trustee, liquidator or custodian of the Corporation or of all or a substantial part of the property thereof, or an involuntary case or other proceedings seeking liquidation, reorganization or other relief with respect to the Corporation or the debts thereof under any bankruptcy, insolvency or other similar law shall be commenced and an order for relief entered or such proceeding shall not be dismissed or discharged within 60 days of commencement; or

(f) The Loan Agreement or any material term thereof shall cease to be, or be asserted by the Corporation not to be, a legal, valid and binding obligation of the Corporation enforceable in accordance with its terms; or

(g) The instructions to the Attorney General of the State regarding disbursing the Corporation Tobacco Assets to the Trustee as provided in the Loan Agreement shall be revoked or cease to be complied with.

Remedies

At any time after the occurrence and during the continuance of any Event of Default, the Authority may, by written notice to the Corporation exercise any other right, power or remedy available to it by law or in equity, either by suit in equity or by action at law, or both. No remedy conferred in the Loan Agreement upon or reserved to the Authority is intended to be exclusive of any other available remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Loan Agreement or existing at law or in equity. No delay or omission to exercise any right or power accruing upon any Default shall impair any such right or power or shall be construed to be a waiver thereof, but any such right or power may be exercised from time to time and as often as may be deemed expedient. Such rights and remedies as are given the Authority under the Loan Agreement shall also extend to the Trustee, and the Trustee and the Owners, subject to the provisions of the Indenture, shall be entitled to the benefit of all covenants and agreements contained in the Loan Agreement. Notwithstanding any other provision of the Loan Agreement, the Authority and the Indenture Trustee shall not sell or foreclose on the Corporation Assets, even if an Event of Default has occurred.

Amendments

The Loan Agreement may be amended by the Corporation and the Authority, with the consent of the Trustee: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the Loan Agreement; (c) to correct or amplify the description of the Corporation Tobacco Assets; (d) to add additional covenants for the benefit of the Authority; (e) in connection with the issuance of Additional Bonds or Additional Subordinate Bonds; or (f) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Loan Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Trustee, adversely affect in any material respect payment of the Bonds. Promptly after the execution of any such amendment, the Corporation shall furnish written notification of the substance of such amendment to the Rating Agencies.

PURCHASE AND SALE AGREEMENT

The Purchase and Sale Agreement provides the terms of the sale by the County, as seller, and the purchase by the Corporation, as purchaser, of the County Tobacco Assets. Certain of the provisions of the Purchase and Sale Agreement are summarized below. This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Purchase and Sale Agreement.

The Purchase and Sale Agreement was executed and delivered by the County and the Corporation in 2001 in connection with the issuance of the Series 2001 Bonds. As used under this heading "PURCHASE AND SALE AGREEMENT," the term "Closing Date" means the date of issuance of the Series 2001 Bonds, the term "Indenture" means the indenture relating to the Series 2001 Bonds, the term "Loan Agreement" means the loan agreement in connection with the Series 2001 Bonds and the term "Trustee" means the trustee for the Series 2001 Bonds.

The Purchase and Sale Agreement that was executed and delivered by the County and the Corporation in 2001 provides that:

Agreement to Sell and Purchase

The County agrees to sell, and the Corporation agrees to purchase, on the Closing Date, for consideration paid by the Corporation of the amount set forth in the Purchase and Sale Agreement in cash (the "Purchase Price"), all right, title and interest of the County in, to and under the MOU, the ARIMOU, the MSA and the Consent Decree including, without limitation, the rights of the County to be paid the money due to it under the MOU, the ARIMOU,

the MSA and the Consent Decree from and after the Closing Date (collectively and severally, the "County Tobacco Assets").

Conveyance of County Tobacco Assets and Payment of Purchase Price

In consideration of the payment and delivery by the Corporation to the County of the Purchase Price, pursuant to the Purchase and Sale Agreement, the County does (a) transfer, grant, bargain, sell, assign, convey, set over and deliver to the Corporation, absolutely and not as collateral security, without recourse except as expressly provided therein, and the Corporation does purchase, accept and receive, all of the County's right, title and interest in, to and under the County Tobacco Assets, and (b) assign to the Corporation, to the extent permitted by law (as to which no representation is made), all present or future rights, if any, of the County to enforce or cause the enforcement of payment of the County Tobacco Assets pursuant to the MOU and the ARIMOU.

Representations and Warranties of the Corporation

The Corporation represents and warrants to the County that, effective as of the Closing Date, (a) it is duly organized, validly existing and in good standing in the jurisdiction of its organization, (b) it has full power and authority to enter into the Purchase and Sale Agreement and to perform its obligations under the Purchase and Sale Agreement, (c) neither the execution and delivery of the Purchase and Sale Agreement, nor the performance of its obligations under the Purchase and Sale Agreement, shall conflict with or result in a breach or default under any of its organizational documents, or any law, rule, regulation, judgment, order or decree to which it is subject or any agreement or instrument to which it is a party, and (d) the Purchase and Sale Agreement, and its execution, delivery and performance of the Purchase and Sale Agreement have been duly authorized by it, and the Purchase and Sale Agreement has been duly executed and delivered by it and constitutes its legal, valid and binding obligation enforceable against it in accordance with the terms of the Purchase and Sale Agreement, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

Representations and Warranties of the County

The County by the Purchase and Sale Agreement represents and warrants to the Corporation, as of the Closing Date, as follows:

(a) The County is validly existing as a political subdivision under the laws of the State, with full power and authority to execute and deliver the Purchase and Sale Agreement and to carry out its terms.

(b) The County has full power, authority and legal right to sell and assign the County Tobacco Assets to the Corporation and has duly authorized such sale and assignment to the Corporation by all necessary action; and the execution, delivery and performance of the Purchase and Sale Agreement has been duly authorized by the County by all necessary action.

(c) The Purchase and Sale Agreement has been duly executed and delivered by the County and, assuming the due authorization, execution and delivery of the Purchase and Sale Agreement by the Corporation, constitutes a legal, valid and binding obligation of the County enforceable in accordance with its terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

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

(e) The consummation of the transactions contemplated by the Purchase and Sale Agreement and the fulfillment of the terms thereof do not in any material way conflict with, result in any material breach by the County of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a material

default by the County under any indenture, agreement or other instrument to which the County is a party or by which it is bound; nor violate any law, order, rule or regulation applicable to the County of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the County.

(f) There are no material proceedings or investigations pending against the County before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the County: (i) asserting the invalidity of the Purchase and Sale Agreement, or, to the best of its knowledge, the Loan Agreement, the Indenture or the Bonds, (ii) seeking to prevent the consummation of any of the transactions contemplated by the Purchase and Sale Agreement, or, to the best of its knowledge, the Loan Agreement, the Indenture or the Bonds or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of the Purchase and Sale Agreement, or, to the best of its knowledge, the Loan Agreement, the Indenture or the Bonds. There are no initiatives pending that would affect the County's sale of the County Tobacco Assets or the use of the Purchase Price.

(g) Prior to the sale of the County Tobacco Assets to the Corporation, the County was the sole owner of the County Tobacco Assets, and has such right, title and interest as provided in the MOU and the ARIMOU. From and after the conveyance of the County Tobacco Assets by the County to Corporation on the Closing Date, the County shall have no interest in the County Tobacco Assets.

(h) Except to the extent that the State has the right to reallocate moneys paid under the MOU and the ARIMOU, as provided in the MOU and the ARIMOU, prior to the sale of the County Tobacco Assets to the Corporation, the County held title to the County Tobacco Assets free and clear and without liens, pledges, charges, security interests or any other impediments of any nature concerning the County Tobacco Assets thereon. Except as set forth in the Purchase and Sale Agreement, the County has not sold, transferred, assigned, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the County Tobacco Assets, nor has the County created, or to its knowledge permitted the creation of, any lien thereon.

(i) The County acts solely through its authorized officers or agents.

(j) The County maintains records and books of account separate from both the Corporation and the Authority.

(k) The financial statements and books and records of the County prepared after the Closing Date shall reflect the separate existence of the Corporation and the Authority.

(l) The County maintains its respective assets separately from the assets of both the Corporation and the Authority (including through the maintenance of separate bank accounts); and the County's funds and assets, and records relating thereto, have not been and are not commingled with those of the Corporation or the Authority.

(m) The County's principal place of business and chief executive office is located at 1600 Pacific Highway, San Diego, California 92101.

(n) The County shall treat the sale of the County Tobacco Assets as a sale for tax reporting and accounting purposes, and title to the County Tobacco Assets shall not be a part of the debtor's estate in the event of the filing of a bankruptcy petition by or against the County under any bankruptcy law.

(o) The County has received reasonably equivalent value for the County Tobacco Assets.

(p) The County does not act as an agent of the Corporation or the Authority in any capacity, but instead presents itself to the public as an entity separate from the Corporation and the Authority.

(q) The County has not guaranteed and shall not guarantee the obligations of the Corporation or the Authority, nor shall it hold itself out or permit itself to be held out as having agreed to pay or as being liable for the debts of the Corporation or the Authority; and the County has not received nor shall the County accept, any credit or

financing from any Person who is relying upon the availability of the assets of the Authority or the Corporation to satisfy the claims of such creditor.

(r) All transactions between or among the County, on the one hand, and the Authority and/or the Corporation on the other hand (including, without limitation, transactions governed by contracts for services and facilities, such as payroll, purchasing, accounting, legal and personnel services and office space) shall be on terms and conditions (including, without limitation, terms relating to amounts to be paid thereunder) which are believed by each such party thereto to be both fair and reasonable and comparable to those available on an arms-length basis from Persons who are not affiliates.

Covenants of the County

The County shall not take any actions or omit to take any action which adversely affect the interests of the Corporation in the County Tobacco Assets and in the proceeds thereof. The County shall not take any action or omit to take any action that shall adversely affect the ability of the Corporation, and any assignee of the Corporation, to receive payments made under the MOU, the ARIMOU, the MSA and the Consent Decree; provided, however, that nothing in the Purchase and Sale Agreement shall be deemed to prohibit the County from undertaking any activities (including educational programs, regulatory actions, or any other activities) intended to reduce or eliminate smoking or the consumption or use of tobacco or tobacco related products.

The County shall not take any action or omit to take any action and shall use its 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 MOU or the ARIMOU, or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MOU or the ARIMOU, nor, without the prior written consent of the Corporation or its assignee, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the MOU or the ARIMOU, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Bondholders. Nothing in the Purchase and Sale Agreement shall impose a duty on the County to seek to enforce the MSA or to seek enforcement thereof by others, or to prevent others from modifying, terminating, discharging or impairing the validity or effectiveness of the MSA.

Upon request of the Corporation or its assignee, the County shall 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 and intent of the Purchase and Sale Agreement. The County shall take all actions necessary to preserve, maintain and protect the title of the Corporation to the County Tobacco Assets.

The County shall at all times do and perform all acts and things permitted by law and the Purchase and Sale Agreement which are necessary or desirable in order to assure that interest paid on the Bonds (or any of them) will be excluded from gross income for federal income tax purposes and shall 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 County agrees that it will comply with the provisions of the County Tax Certificate which are incorporated in the Purchase and Sale Agreement.

The County shall execute the County Tax Certificate containing all necessary and appropriate covenants, agreements, representations, statements of intention and reasonable expectations and certifications of fact for bond counsel to render its opinion that interest on the Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code, including but not limited to matters relating to the use and investment of the proceeds of Bonds and any other moneys of the County, and the use of any and all property financed or refinanced with the proceeds of the Bonds received by the County as part of the Purchase Price.

On or before the Closing Date, the County shall send (or cause to be sent) an irrevocable instruction to the Attorney General of the State pursuant to Sections 4.B.(2)(i)(aa) and 4.B.(2)(i)(bb) of the ARIMOU to cause the California Escrow Agent to disburse all of the County Tobacco Assets from the California Escrow to the Trustee, together with notice of the sale of the County Tobacco Assets to the Corporation and the assignment and grant of a security interest in such assets to the Authority, and by the Authority to the Trustee, and an acknowledgement that such instructions shall only be further modified with the countersignature of a designated representative of the

Trustee until the Trustee gives notice to the Attorney General of the State that there are no longer any Bonds Outstanding under the Indenture, after which any further modification must be countersigned by a representative of the Corporation. The County by the Purchase and Sale Agreement relinquishes and waives any control over the County Tobacco Assets, any authority to collect the County Tobacco Assets, and any power to revoke or amend the instructions to the Attorney General contemplated by this paragraph. The County shall not rescind, amend or modify the instruction described in the first sentence of this paragraph. In the event that the County receives any proceeds of any County Tobacco Assets, the County shall hold the same in trust for the benefit of the Corporation, the Authority and the Trustee as their interests may appear and shall promptly remit the same to the Trustee.

The County acknowledges that the proceeds received by the County as part of the Purchase Price pursuant to the Purchase and Sale Agreement continue to be proceeds of the Bonds in the hands of the County and agrees to invest such amounts solely in investments specified in subsections (iv) and (v) of the definition of Eligible Investments to the extent that such proceeds are subject to the investment limitation requirements of the County Tax Certificate.

The County by the Purchase and Sale Agreement covenants and agrees that it will not at any time institute against the Corporation, or join in instituting against the Corporation, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

Notices of Breach

Upon discovery by the County or the Corporation that the County has breached any of its covenants or that any of its representations or warranties are materially false or misleading, in a manner that materially and adversely affects the value of the County Tobacco Assets, the discovering party shall give prompt written notice thereof to the other party, the Trustee and the Rating Agencies.

The County shall not be liable to the Corporation, the Authority, the Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Trustee to promptly notify the County upon the discovery by the Trustee of a breach of any covenant or any materially false or misleading representation or warranty contained in the Purchase and Sale Agreement as required by the Purchase and Sale Agreement.

Liability of County; Indemnification

The County shall be liable in accordance with the Purchase and Sale Agreement only to the extent of the obligations specifically undertaken by the County under the Purchase and Sale Agreement, as follows: the County shall indemnify, defend and hold harmless the Corporation, the Authority and the Trustee and their respective officers, directors, employees and agents from and against any and all costs, expenses, losses, claims, damages and liabilities to the extent that such cost, expense, loss, claim, damage or liability arose out of, or was imposed upon any such Person by the County's breach of any of its covenants contained in the Purchase and Sale Agreement or any materially false or misleading representation or warranty of the County contained in the Purchase and Sale Agreement. The County shall indemnify, defend and hold harmless the Corporation, the Authority and the Trustee and their respective officers, directors, employees and agents from and against any and all costs, expenses, losses, claims, damages and liabilities arising out of or incurred in connection with the County's obligations under the County Tax Certificate, including any rebate or other obligation to the United States Department of the Treasury, resulting from actions by or omissions of the County, including from the investment of the proceeds of the Bonds by the County and the use of any and all property financed or refinanced with the proceeds of such Bonds received by the County as part of the Purchase Price.

Limitation on Liability

The County and any officer or employee or agent of the County may rely in good faith on the advice of counsel, or on any document of any kind prima facie properly executed and submitted by any Person respecting any matters arising under the Purchase and Sale Agreement.

No officer or employee of the County shall have any liability for the representations, warranties, covenants, agreements or other obligations of the County under the Purchase and Sale Agreement or in any of the certificates, notices or agreements delivered pursuant to the Purchase and Sale Agreement, as to all of which recourse shall be had solely to the assets of the County.

County's Acknowledgment

The County by the Purchase and Sale Agreement agrees and acknowledges that the Corporation intends to assign and grant a security interest in its rights under the Purchase and Sale Agreement and its rights to the County Tobacco Assets to the Authority pursuant to the terms of the Loan Agreement, and that the Authority intends to assign and grant a security interest in the same to the Trustee pursuant to the Indenture. The County further agrees and acknowledges that the Authority, the Trustee and the Bondholders have relied and shall continue to rely upon each of the foregoing representations and warranties, and further agrees that such Persons are entitled so to rely thereon. Each of the above representations and warranties shall survive any assignment and grant of a security interest in the Purchase and Sale Agreement or the County Tobacco Assets to the Authority and by the Authority to the Trustee, and shall continue in full force and effect, notwithstanding any subsequent termination of the Purchase and Sale Agreement and the other Basic Documents. The above representations and warranties shall inure to the benefit of Authority and the Trustee.

Corporation's Acknowledgment

The Corporation by the Purchase and Sale Agreement agrees and acknowledges that the County is irrevocably transferring, granting, bargaining, selling, assigning, conveying, and delivering to the Corporation the County Tobacco Assets without recourse, and, except as expressly set forth above, without representation or warranty of any kind or description.

Intent to Effect Irrevocable, Absolute Sale and not a Transfer as Collateral or Security

The County and the Corporation by the Purchase and Sale Agreement confirm their intent and agree that the County is irrevocably transferring, granting, bargaining, selling, assigning, conveying and delivering to the Corporation the County Tobacco Assets absolutely and not as collateral security.

Amendments

This Agreement may be amended by the County and the Corporation, with the consent of the Trustee: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the Purchase and Sale Agreement; (c) to correct or amplify the description of the County Tobacco Assets; (d) to add additional covenants for the benefit of the Corporation; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Purchase and Sale Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Trustee, adversely affect in any material respect payment of the Bonds.

Promptly after the execution of any such amendment, the Corporation shall furnish written notification of the substance of such amendment to the Rating Agencies.

(THIS PAGE INTENTIONALLY LEFT BLANK)

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 the Authority, the Borrower, the County and the Underwriters take no responsibility for the completeness or accuracy thereof. The Authority, the Borrower, the County 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, interest, or Accreted Value of the Series 2006 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2006 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2006 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 Series 2006 Bonds. The Series 2006 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 each maturity of the Series 2006 Bonds, in the aggregate initial principal amount of such Series 2006 Bonds, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-United States equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation and Emerging Markets Clearing Corporation (respectively, "NSCC," "FICC," and "EMCC," also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Series 2006 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2006 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 Series 2006 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in

the Series 2006 Bonds, except in the event that use of the book-entry system for the Series 2006 Bonds is discontinued. To facilitate subsequent transfers, all Series 2006 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2006 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2006 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2006 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2006 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2006 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2006 Bond documents. For example, Beneficial Owners of the Series 2006 Bonds may wish to ascertain that the nominee holding the Series 2006 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 will 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 Series 2006 Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Series 2006 Bonds by the Authority will reduce the outstanding principal amount or Accreted Value of the Series 2006 Bonds held by DTC. In such event, DTC will implement, through its Book-Entry system, redemption of interests in the Series 2006 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 Series 2006 Bonds for the Beneficial Owners.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2006 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2006 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, prepayments and payments of principal, interest, or Accreted Value of the Series 2006 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, prepayments and payments of principal, interest, or Accreted Value of the Series 2006 Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and

disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE AUTHORITY, THE BORROWER, THE COUNTY, THE UNDERWRITERS OR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2006 Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, security certificates are required to be printed and delivered. To the extent permitted by law, the Authority may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. In the event that the Book-Entry system is discontinued as described above, the requirements of the Indenture will apply.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX H

Table of Accreted Values
(Accreted Values Shown Per $5,000 Maturity Amount)

Dates	Series 2006B First Subordinate CABs Accreted Value	Series 2006C Second Subordinate CABs Accreted Value	Series 2006D Third Subordinate CABs Accreted Value
May 31, 2006	$426.40	$402.30	$306.85
December 1, 2006	439.80	415.25	317.80
June 1, 2007	453.54	428.53	329.09
December 1, 2007	467.72	442.25	340.77
June 1, 2008	482.33	456.40	352.86
December 1, 2008	497.40	471.00	365.39
June 1, 2009	512.95	486.07	378.36
December 1, 2009	528.98	501.63	391.79
June 1, 2010	545.51	517.68	405.70
December 1, 2010	562.55	534.24	420.10
June 1, 2011	580.13	551.34	435.02
December 1, 2011	598.26	568.98	450.46
June 1, 2012	616.95	587.19	466.45
December 1, 2012	636.23	605.98	483.01
June 1, 2013	656.12	625.37	500.15
December 1, 2013	676.62	645.38	517.91
June 1, 2014	697.76	666.03	536.29
December 1, 2014	719.57	687.34	555.33
June 1, 2015	742.05	709.34	575.04
December 1, 2015	765.24	732.04	595.46
June 1, 2016	789.15	755.46	616.60
December 1, 2016	813.81	779.63	638.48
June 1, 2017	839.24	804.58	661.15
December 1, 2017	865.47	830.33	684.62
June 1, 2018	892.51	856.90	708.92
December 1, 2018	920.40	884.32	734.09
June 1, 2019	949.17	912.62	760.15
December 1, 2019	978.83	941.82	787.13
June 1, 2020	1,009.41	971.96	815.07
December 1, 2020	1,040.96	1,003.06	844.01
June 1, 2021	1,073.48	1,035.15	873.97
December 1, 2021	1,107.03	1,068.28	904.99
June 1, 2022	1,141.62	1,102.46	937.12
December 1, 2022	1,177.30	1,137.74	970.38
June 1, 2023	1,214.09	1,174.15	1,004.83
December 1, 2023	1,252.03	1,211.72	1,040.50
June 1, 2024	1,291.15	1,250.49	1,077.44
December 1, 2024	1,331.50	1,290.51	1,115.69
June 1, 2025	1,373.11	1,331.80	1,155.29
December 1, 2025	1,416.01	1,374.42	1,196.30
June 1, 2026	1,460.26	1,418.40	1,238.77
December 1, 2026	1,505.89	1,463.79	1,282.74
June 1, 2027	1,552.95	1,510.62	1,328.28
December 1, 2027	1,601.48	1,558.96	1,375.43
June 1, 2028	1,651.52	1,608.85	1,424.26
December 1, 2028	1,703.13	1,660.33	1,474.82
June 1, 2029	1,756.35	1,713.46	1,527.17
December 1, 2029	1,811.24	1,768.29	1,581.38

Dates	Series 2006B First Subordinate CABs Accreted Value	Series 2006C Second Subordinate CABs Accreted Value	Series 2006D Third Subordinate CABs Accreted Value
June 1, 2030	1,867.84	1,824.87	1,637.52
December 1, 2030	1,926.20	1,883.27	1,695.65
June 1, 2031	1,986.39	1,943.53	1,755.84
December 1, 2031	2,048.47	2,005.72	1,818.17
June 1, 2032	2,112.48	2,069.90	1,882.71
December 1, 2032	2,178.49	2,136.14	1,949.55
June 1, 2033	2,246.57	2,204.49	2,018.75
December 1, 2033	2,316.77	2,275.03	2,090.42
June 1, 2034	2,389.17	2,347.83	2,164.62
December 1, 2034	2,463.83	2,422.96	2,241.46
June 1, 2035	2,540.82	2,500.49	2,321.03
December 1, 2035	2,620.21	2,580.51	2,403.43
June 1, 2036	2,702.09	2,663.08	2,488.74
December 1, 2036	2,786.53	2,748.29	2,577.09
June 1, 2037	2,873.61	2,836.24	2,668.57
December 1, 2037	2,963.40	2,926.99	2,763.30
June 1, 2038	3,056.01	3,020.66	2,861.40
December 1, 2038	3,151.50	3,117.31	2,962.97
June 1, 2039	3,249.98	3,217.06	3,068.15
December 1, 2039	3,351.54	3,320.01	3,177.07
June 1, 2040	3,456.27	3,426.24	3,289.85
December 1, 2040	3,564.28	3,535.88	3,406.63
June 1, 2041	3,675.66	3,649.03	3,527.57
December 1, 2041	3,790.52	3,765.79	3,652.79
June 1, 2042	3,908.97	3,886.29	3,782.46
December 1, 2042	4,031.12	4,010.65	3,916.73
June 1, 2043	4,157.09	4,138.99	4,055.77
December 1, 2043	4,286.99	4,271.43	4,199.74
June 1, 2044	4,420.95	4,408.11	4,348.83
December 1, 2044	4,559.10	4,549.17	4,503.20
June 1, 2045	4,701.57	4,694.74	4,663.06
December 1, 2045	4,848.49	4,844.97	4,828.59
June 1, 2046	5,000.00	5,000.00	5,000.00

INDEX

PACIFIC FINANCIAL PRINTING