NEW ISSUE **BOOK–ENTRY ONLY**

In the opinion of Sidley Austin Brown & Wood LLP, Transaction Counsel, assuming continuing compliance with the provisions of the Internal Revenue Code of 1986, as amended, as described herein, interest on the Series 2002-1 Bonds will not be includable in the gross income of the owners thereof for federal, New York State or New York City income tax purposes. See "Tax Exemption and Other Tax Matters" herein for further information.

$500,000,000

TSASC, INC.

Tobacco Settlement Asset-Backed Bonds, Series 2002-1

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

The Tobacco Settlement Asset-Backed Bonds, Series 2002-1 (the "**Series 2002-1 Bonds**") are a Series of parity Senior Bonds of TSASC to be issued pursuant to an Indenture between TSASC and The Bank of New York, as successor Indenture Trustee, and a Series Supplement to such Indenture (as such terms are defined herein).

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

The Series 2002-1 Bonds and all other Series of Senior Bonds are secured by and payable solely from (i) the TSRs and investment earnings on accounts pledged under the Indenture (as more fully defined herein, the "**Collections**"), (ii) amounts held in certain reserve accounts established under the Indenture (as more fully defined herein, the "**Reserves**") and (iii) amounts held in the other accounts established under the Indenture. TSASC has no financial assets other than the TSRs, the Reserves and amounts held in accounts established under the Indenture.

Payment of the Series 2002-1 Bonds is dependent on receipt of TSRs. The amount of TSRs actually collected is dependent on many factors including cigarette consumption and the finances of participating cigarette manufacturers. See "Risk Factors" beginning on page 2 for a discussion of certain factors that should be considered in connection with an investment in the Series 2002-1 Bonds.

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

The Series 2002-1 Bonds are not debt of the State of New York (the "State") or the City, and neither the State nor the City is liable thereon. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, the revenues nor the taxing power of the State or the City is, or shall be deemed to be, pledged to the payment of any of the Series 2002-1 Bonds. TSASC has no taxing power.

Bear, Stearns & Co. Inc.

JPMorgan **Salomon Smith Barney**

First Albany Corporation **Goldman, Sachs & Co.** **Lehman Brothers**
Merrill Lynch & Co. **Morgan Stanley** **RBC Dain Rauscher**
UBS PaineWebber Inc.

ABN-AMRO **Banc One Capital Markets** **CMI/Capital Market Investment, LLC**
CIBC World Markets **Fidelity Capital Markets** **Loop Capital Markets**
M.R. Beal & Company **Ramirez & Co.** **Raymond, James & Associates Inc.**
Roosevelt & Cross Incorporated **SWS Securities** **Siebert Brandford Shank & Co.**
Wachovia Bank National Association

August 1, 2002

(Continued from front cover)

Interest on the Series 2002-1 Bonds will be payable semi-annually on January 15 and July 15 of each year, commencing January 15, 2003.

Scheduled principal payments on the Series 2002-1 Bonds will consist of either Principal Installments or Super Sinker Redemptions (as such terms are defined herein), and are payable as provided herein. Principal Installments represent the amount of principal that TSASC will pay on the Series 2002-1 Bonds from Collections and, if necessary, Reserves. Failure to pay interest on the Series 2002-1 Bonds or failure to pay any Principal Installment of the Series 2002-1 Bonds when due will constitute an Event of Default as described herein. **The ratings of the Series 2002-1 Bonds address TSASC's ability to pay interest and Principal Installments on the Series 2002-1 Bonds when due.**

Super Sinker Redemptions represent the amount of principal TSASC has covenanted to pay on certain of the Series 2002-1 Bonds, to the extent of available Collections, as provided herein. Failure to make Super Sinker Redemptions will not constitute an Event of Default. However, no payments will be made to the City with respect to the Residual Certificate (as defined herein), and no additional Senior Bonds may be issued, as described herein, unless TSASC is current on all Super Sinker Redemptions. **The ratings of the Series 2002-1 Bonds do not address TSASC's ability to make Super Sinker Redemptions.**

The Series 2002-1 Bonds are also subject to optional redemption and, under certain circumstances, Extraordinary Prepayment prior to the scheduled payment dates of their respective Principal Installments, as described herein. Certain of the Series 2002-1 Bonds are also subject to mandatory sinking fund redemptions as described herein.

The Series 2002-1 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Sidley Austin Brown & Wood LLP, New York, New York, as Transaction Counsel. Certain legal matters with respect to TSASC and the City will be passed upon by the City's Corporation Counsel and Sidley Austin Brown & Wood LLP, as Transaction Counsel. Certain legal matters will be passed upon for the Underwriters by Orrick, Herrington & Sutcliffe LLP, New York, New York, as Underwriters' Counsel. It is expected that the Series 2002-1 Bonds will be available for delivery in book-entry only form through The Depository Trust Company in New York, New York on or about August 15, 2002.

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

$500,000,000
Series 2002-1 Bonds
Dated: Date of Delivery

$65,430,000 Fixed Amortization Serial Bonds

Maturity Date (July 15)	Principal Amount	Interest Rate	Price or Yield
2006	$ 1,425,000	3 %	100%
2007	1,420,000	3.40	100
2008	7,735,000	3¾	3.85
2009	8,390,000	4	4.20
2010	9,125,000	4¼	4.40
2011	6,830,000	5¼	4.55
2012	10,900,000	4½	4.70
2013	7,470,000	5½	4.85*
2014	12,135,000	5	100

$190,710,000 5½% Super Sinker Term Bonds Due July 15, 2024 Yield 5.75%
Projected Final Super Sinker Redemption Date: July 15, 2018**
(Projected Average Life: 9.2 years)**

$243,860,000 5¾% Super Sinker Term Bonds Due July 15, 2032 Yield 6.00%
Projected Final Super Sinker Redemption Date: July 15, 2025**
(Projected Average Life: 19.7 years)**

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* Priced to the par call on July 15, 2012.

** Assumes timely payment of all Super Sinker Redemptions. Projections of expected average life and final Super Sinker Redemptions have not been rated by the Rating Agencies. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" and "THE SERIES 2002-1 BONDS".

CERTAIN PERSONS PARTICIPATING IN THIS OFFERING MAY ENGAGE IN TRANSACTIONS THAT STABILIZE OR MAINTAIN THE PRICE OF THE SERIES 2002-1 BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET, OR OTHERWISE AFFECT THE PRICE OF THE SERIES 2002-1 BONDS OFFERED HEREBY, INCLUDING OVER-ALLOTMENT AND STABILIZING TRANSACTIONS. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED IN CONNECTION WITH ANY OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY TSASC, THE CITY OR THE UNDERWRITERS. THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, ANY OF THE SERIES 2002-1 BONDS 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 2002-1 BONDS WILL DEVELOP, OR IF ONE DEVELOPS, THAT IT WILL CONTINUE.

The information set forth herein has been furnished by TSASC, the City and DRI•WEFA (as defined herein) and includes information obtained from other sources, all of which are believed to be reliable. The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of TSASC or the matters covered by the report of DRI•WEFA included as Appendix A to this Offering Circular since the date hereof or that the information contained herein is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Collections (see "RISK FACTORS" and "SUMMARY OF THE MSA" herein), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by TSASC, the City, DRI•WEFA 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," and analogous expressions are intended to identify forward-looking statements, and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. Such risks and uncertainties include, among others, general economic and business conditions, changes in political, social and economic conditions, regulatory initiatives and compliance with governmental regulations, litigation and various other events, conditions and circumstances, many of which are beyond the control of TSASC. These forward-looking statements speak only as of the date of this Offering Circular. TSASC disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in TSASC's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

THE SERIES 2002-1 BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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 2002-1 Bonds to potential investors is made only by means of the entire Offering Circular. For definitions of certain terms used herein, see "Index of Defined Terms" herein.

Overview . . . . TSASC is issuing $500,000,000 aggregate principal amount of its Tobacco Settlement Asset-Backed Bonds, Series 2002-1 (the "**Series 2002-1 Bonds**"). The Series 2002-1 Bonds are a series (each, a "**Series**") of parity senior bonds of TSASC (collectively, the "**Senior Bonds**") issued or expected to be issued under the Indenture hereinafter referred to.

TSASC has purchased all of the right, title and interest of The City of New York (the "**City**") under the Master Settlement Agreement (the "**MSA**") and the Consent Decree and Final Judgment (the "**Decree**"), including the City's right to receive its portion of the Tobacco Settlement Revenues or TSRs pursuant to the TSR Purchase Agreement hereinafter referred to. The Series 2002-1 Bonds are secured by, and are payable solely from, the TSRs and certain pledged accounts, all as more fully described herein.

Upon the issuance of the Series 2002-1 Bonds, approximately $1.228 billion principal amount of Senior Bonds will be outstanding. TSASC may issue up to an aggregate principal amount of approximately $2.8 billion of Senior Bonds under the Indenture, depending on actual Debt Service (as defined herein) at the time of issuance, without Rating Confirmation (as defined herein) if certain criteria are met. Senior Bonds which meet such criteria may be issued without Rating Confirmation and are herein referred to as "**Program Bonds**." All Bonds issued to date and the Series 2002-1 Bonds are Program Bonds. See "THE SERIES 2002-1 BONDS—Additional Series of Bonds" and "RATINGS" herein. Each Series of Senior Bonds is and will be on a parity with each other Series of Senior Bonds. The Senior Bonds, any bond anticipation notes ("**BANs**") and any Subordinate Bonds (as defined herein) are referred to herein as "**Bonds**."

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

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

	from, the City. TSASC is operated exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "**Code**").
Securities Offered	The Series 2002-1 Bonds will be issued pursuant to an Indenture, dated as of November 1, 1999, as amended to date (the "**Indenture**"), between TSASC and The Bank of New York, as successor in interest to the United States Trust Company of New York, as trustee (the "**Indenture Trustee**"), and a series supplement to the Indenture (the "**Series 2002-1 Supplement**"), to be entered into between TSASC and the Indenture Trustee in connection with the issuance of the Series 2002-1 Bonds. It is expected that the Series 2002-1 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about August 15, 2002 (the "**Closing Date**"). Individual purchases of beneficial ownership interests may be made in the principal amount of $5,000 or any integral multiple thereof. Beneficial owners of the Series 2002-1 Bonds will not receive physical delivery of bond certificates.
Collateral	The Series 2002-1 Bonds, together with the other Senior Bonds, will be secured by a perfected first-priority security interest in, and pledge of, all of TSASC's tangible and intangible assets, including the Tobacco Settlement Revenues and all investment earnings on amounts on deposit in the Accounts established under the Indenture (collectively, the "**Collections**"), all amounts on deposit in the Liquidity Reserve Account, the Trapping Account and the Extraordinary Prepayment Account, if any (collectively, the "**Reserves**"), and all amounts on deposit in the other Accounts established under the Indenture.
Master Settlement Agreement	The MSA was entered into on November 23, 1998, between 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 Territory of the Northern Marianas (collectively, the "**Settling States**") and the four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**"). The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past, present and future smoking-related claims by the Settling States, and provides for a continuing release of future smoking-related claims in exchange for certain payments to be made to the Settling States (including Initial Payments and Annual Payments, as defined herein). The MSA also provides for the imposition of certain tobacco advertising and marketing restrictions, among other things.

TSASC is not a party to the MSA.

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

MSA Payments .... Under the MSA, the OPMs are required to make the following payments (in which the City has an interest under the Decree) to the Settling States:

(i) five initial payments ranging from $2.4 billion to $2.7 billion (the "**Initial Payments**"), four of which have been paid and the fifth of which is required to be paid on January 10, 2003; and

(ii) annual payments (the "**Annual Payments**") which are required to be made annually on each April 15, commencing April 15, 2000, and continuing in perpetuity (of which the April 15, 2000, 2001 and 2002 annual payments have already been made) in the following base amounts, which are subject to adjustment as hereinafter described:

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

All payments received and to be received by the City under the MSA and the Decree are collectively referred to herein as the "**Tobacco Settlement Revenues**" or "**TSRs**".*

The Initial Payments and Annual Payments due under the MSA are subject to numerous adjustments, some of which could be material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions for

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* Certain other payments such as strategic contribution payments, payments of attorneys' fees and payments to a national foundation established pursuant to the MSA, are also required to be made by the PMs. As these payments are not allocated to the City under the Decree and are thus not available to TSASC, they are not included as "Tobacco Settlement Revenues" and are not discussed herein.

amounts paid by OPMs to four states which had previously settled their claims against the PMs independently of the MSA, and increases related to inflation in an amount of not less than 3% per year.

"**Final Approval**" of the MSA occurred on November 12, 1999, when 80% of the Settling States (including the State) by number and dollar volume achieved State-Specific Finality (as defined herein). Citibank, N.A., as the escrow agent appointed pursuant to the MSA (the "**MSA Escrow Agent**"), distributed the up-front Initial Payment upon Final Approval, and subsequently distributed the Initial Payments and Annual Payments due to date to the Settling States that had achieved State-Specific Finality.

Under the MSA, each OPM is required to pay an allocable portion of each Initial Payment and Annual Payment based on its relative market share of the United States cigarette market during the preceding calendar year, subject to certain adjustments as described herein. Each SPM has Annual Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share. The SPMs have no payment obligations with respect to the Initial Payments. Payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs are required to be made to the MSA Escrow Agent. See "SUMMARY OF THE MSA" herein.

New York Consent Decree.......... Under the MSA, the State is entitled to 12.7620310% of the Initial Payments and Annual Payments made by PMs under the MSA. The Decree, which was entered by the Supreme Court of the State of New York in December 1998, allocates this share of the Initial Payments and Annual Payments among the State (51.176%), the City (26.670%) and certain counties within the State (22.154%). The Decree became final on August 17, 1999 and is not subject to further appeal. As a result, New York State has achieved State-Specific Finality (as defined herein) under the MSA. See "SUMMARY OF THE MSA" and "NEW YORK CONSENT DECREE" herein.

Sale of Tobacco Settlement Revenues .... Pursuant to a Purchase and Sale Agreement dated as of November 18, 1999 (the "**TSR Purchase Agreement**"), the City sold to TSASC all of its right, title and interest under the MSA and the Decree, including the City's right to receive its portion of the Tobacco Settlement Revenues. As a result, TSASC is entitled to receive approximately 3.40% of the Initial Payments and Annual Payments made by the PMs under the MSA on or after November 18, 1999. Under the Indenture, TSASC has assigned and pledged the TSRs to the Indenture Trustee. The State and the City have issued irrevocable instructions informing the MSA Escrow Agent that payments of TSRs owed to the City have been sold to TSASC and directing the MSA Escrow Agent to disburse the TSRs directly to the Indenture Trustee. Accordingly, the moneys to which TSASC is entitled do not pass through the State or the City and are not subject to State or City appropriation. The Indenture Trustee has received TSASC's share of all Initial Payments and Annual Payments made to date by the PMs under the MSA. The State is entitled to receive additional payments in which the City does not have an interest under the Decree.

The purchase price paid by TSASC to the City under the TSR Purchase Agreement consisted of: (i) the net proceeds of the sale of the Series 1999-1 Bonds (as herein defined) and (ii) TSASC's 100% beneficial ownership interest in the TSASC Tobacco Settlement Trust (the "**Trust**"). Upon the sale of the Series 2002-1 Bonds, TSASC will pay the net proceeds of the sale of the Series 2002-1 Bonds to the Trust. The assets of the Trust consist primarily of a security (the "**Residual Certificate**") which entitles the Trust to the net proceeds of TSASC's Bonds issued after the Series 1999-1 Bonds (other than refunding Bonds), and to TSRs received by TSASC that are not required to fund various expenses, debt service or required reserves with respect to the Bonds. The City owns the sole beneficial interest in the Trust. See "THE TSR PURCHASE AGREEMENT" and "SECURITY FOR THE BONDS" herein.

Industry Overview .... The four OPMs, Philip Morris, Reynolds Tobacco, B&W and Lorillard, are the largest manufacturers of cigarettes in the United States (based on 2001 market share). According to Loews Corporation ("**Loews**"), the corporate parent of Lorillard, the OPMs accounted for approximately 94%* of the United States domestic cigarette market in 2001 based on shipments. The market for cigarettes is highly competitive and is characterized by brand recognition and loyalty. See "TOBACCO INDUSTRY" herein.

Cigarette Consumption .... As described in the DRI•WEFA Report (as defined below), domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980's and 1990's, reaching an estimated level of 419 billion cigarettes in 2001. See "DRI•WEFA REPORT" herein.

DRI•WEFA Report .... DRI•WEFA, Inc. ("**DRI•WEFA**"), an international econometric and consulting firm, has been retained by TSASC to

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* Market share information for the OPMs based on shipments may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Initial Payments and Annual Payments. See "SUMMARY OF THE MSA—Initial Payments" and "—Annual Payments." Additionally, aggregate market share information as reported by Loews 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. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" and "TOBACCO INDUSTRY" herein.

forecast cigarette consumption in the United States from 2001 through 2042. DRI•WEFA considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth, and qualitative variables that capture the impact of anti-smoking regulations, legislation and health warnings. After extensive analysis, DRI•WEFA 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 2000 and an analysis of these variables, DRI•WEFA constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the United States. Using standard multivariate regression analysis to determine the relationship between such variables and CPC along with DRI•WEFA's standard adult population growth forecast and adjustments for non-adult smoking, DRI•WEFA projected adult cigarette consumption out to 2042. DRI•WEFA's report, entitled *A Forecast of U.S. Cigarette Consumption (2001-2042) for TSASC, Inc.* (the "**DRI•WEFA Report**"), is attached hereto as Appendix A and should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The DRI•WEFA Report is subject to certain disclaimers and qualifications described in Appendix A.

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

Existing Obligations and Additional Senior Bonds . . . . The first Series of Senior Bonds (the "**Series 1999-1 Bonds**") was issued in an aggregate principal amount of $709,280,000 on November 18, 1999 of which $685,315,000 remain outstanding. Pursuant to a Secured Loan Agreement and Inducement Agreement dated as of December 1, 2001 (the "**TIFIA Loan Agreement**") between TSASC, the United States Department of Transportation and the City, TSASC issued Senior Bonds in the amount of approximately $42.6 million and has the ability to issue an additional approximately $116.6 million principal amount of Senior Bonds, plus capitalized interest. See "THE INDENTURE—TIFIA Loan Agreement".

TSASC may issue additional Senior Bonds on a parity with the Series 2002-1 Bonds and other Senior Bonds (a) with confirmation from each Rating Agency then rating the Senior Bonds that such issuance will not cause the outstanding ratings on any Senior Bonds to be lowered or withdrawn (such confirmation, a "**Rating Confirmation**"), or (b) without Rating Confirmation if each of the following conditions are satisfied: (i) aggregate annual debt service (calculated separately for Principal Installments and Super Sinker Redemptions) on all outstanding Senior Bonds*, after giving effect to the proposed issuance, does not exceed the Annual Program Debt Service Schedule in any Fiscal Year (see "THE SERIES 2002-1 BONDS—Annual Program Debt Service Schedules" herein); (ii) the Liquidity Reserve Account and the Trapping Account are funded to their respective requirements; (iii) TSASC is current on all Super Sinker Redemptions due on the outstanding Senior Bonds; and (iv) no Event of Default has occurred under the Indenture. Each subsequent Series of Bonds will be issued pursuant to the Indenture and a series supplement to the Indenture (each, a "**Series Supplement**").

Bond Anticipation Notes (BANs) . . . TSASC may issue BANs (a) upon Rating Confirmation or (b) subject to authorization of a Series of Program Bonds in anticipation of which the BANs are to be issued and satisfaction of the conditions described above for the issuance of Program Bonds or (c) to renew BANs. The principal of any BANs will not be payable from Collections. Interest on BANs will be payable from Collections either on a parity with, or junior to, payments of interest on Senior Bonds, as specified in the applicable Series Supplement.

Subordinate Bonds . . . . TSASC may issue additional Bonds that are subordinate to the Senior Bonds and BANs upon Rating Confirmation ("**Subordinate Bonds**").

Bond Structuring Assumptions and Amortization . . . . Certain assumptions and methodologies were used to calculate a forecast of Collections to be received by TSASC, including a forecast of United States cigarette consumption based on the DRI•WEFA Report and the application of certain adjustments and offsets to payments to be made by the PMs pursuant to the MSA. Once Collections were forecasted, certain structuring assumptions for the Bonds were applied. The Principal Installments and Super Sinker Redemptions have been

* The term "Principal Installments" includes "Rated Maturities", and the term "Super Sinker Redemptions" includes "Planned Principal Payments", when used in respect of prior issuances of Senior Bonds, or in respect of terms that include such prior issuances, such as "all Senior Bonds" and "all Program Bonds."

	structured for the Program Bonds so as to result in Debt Service (as defined herein) that is equal to or less than the amounts shown in the schedule contained under the heading "THE SERIES 2002-1 BONDS—Annual Program Debt Service Schedule." No assurance can be given, however, that events will occur in accordance with such assumptions. Any deviations from such assumptions could be material. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION."
Interest	Interest on the outstanding principal amount of the Series 2002-1 Bonds will be payable on January 15 and July 15 of each year (each, a "**Distribution Date**"), commencing January 15, 2003. Interest will be computed on the basis of a 360-day year consisting of twelve 30-day months. If on any Distribution Date there are insufficient funds to pay all interest then due on the Senior Bonds, available amounts will be allocated pro rata among all Senior Bonds based on the respective amounts of interest due thereon. Interest on the Series 2002-1 Bonds through July 15, 2003 will be funded from proceeds of the Series 2002-1 Bonds.
Series 2002-1 Bonds	The Series 2002-1 Bonds will consist of (i) Fixed Amortization Serial Bonds ("**Fixed Amortization Serial Bonds**") and (ii) Super Sinker Term Bonds ("**Super Sinker Term Bonds**").
Scheduled Principal Payments.......	Scheduled principal payments on the Series 2002-1 Bonds will consist of Principal Installments and Super Sinker Redemptions.
Principal Installments	"**Principal Installments**" will consist of (i) principal payments on the stated maturity dates of the Fixed Amortization Serial Bonds ("**Serial Maturities**"), (ii) mandatory sinking fund installment payments on the Super Sinker Term Bonds ("**Mandatory Sinking Fund Installments**") and (iii) principal payments on the stated maturity dates of the Super Sinker Term Bonds ("**Super Sinker Term Bond Maturities**"). The Distribution Date on which a Principal Installment is scheduled to be paid in respect of a Series 2002-1 Bond or other Senior Bond is referred to herein as a "**Principal Installment Payment Date**". Principal Installments represent the amount of principal that TSASC will pay on the Senior Bonds as of the specified Principal Installment Payment Dates from Collections and, if necessary, from Reserves, including the Liquidity Reserve Account hereinafter referred to. A failure by TSASC to pay all or a portion of any Principal Installment on the relevant Principal Installment Payment Date, taking into account all payments of principal made on or prior to such Principal Installment Payment Date in respect of the applicable Senior Bond (including Super Sinker Redemptions), will constitute an Event of Default under the Indenture and could result in the Extraordinary Prepayment of the Senior Bonds, including the Series 2002-1 Bonds, on a

semiannual basis in order of their maturity as described herein. **The ratings of the Series 2002-1 Bonds address the ability of TSASC to pay interest and Principal Installments when due.**

Super Sinker Redemptions . . . . "**Super Sinker Redemptions**" represent the amount of principal TSASC has covenanted to pay on certain of the Senior Bonds, including the Super Sinker Term Bonds, to the extent of available Collections, as of specified Distribution Dates (each, a "**Super Sinker Redemption Date**"). Super Sinker Redemptions will not be made from the Liquidity Reserve Account. To the extent that Super Sinker Redemptions are paid, such payments will be credited against Principal Installments on the applicable Senior Bonds according to the schedule of Super Sinker Redemptions provided herein. Failure to make Super Sinker Redemptions will not constitute an Event of Default. However, no payments will be made to the City with respect to the Residual Certificate and no additional Senior Bonds may be issued unless and until TSASC is current in respect of all Super Sinker Redemptions. If TSASC is unable to make a Super Sinker Redemption on a given Super Sinker Redemption Date, principal could be paid in respect of Super Sinker Redemptions, to the extent of available Collections, as frequently as semiannually on subsequent Distribution Dates, until TSASC is current in respect of all Super Sinker Redemptions. **The ratings of the Series 2002-1 Bonds do not address TSASC's ability to make Super Sinker Redemptions.**

Liquidity Reserve Account . . . . A reserve account (the "**Liquidity Reserve Account**") has been established under the Indenture. The Liquidity Reserve Account is held by the Indenture Trustee. TSASC is required to maintain a balance in the Liquidity Reserve Account, to the extent of available funds (including proceeds of Senior Bonds available therefor), equal to the Liquidity Reserve Requirement. Pursuant to the Series 2002-1 Supplement, "**Liquidity Reserve Requirement**" will be defined as the maximum annual Debt Service (as herein defined) past, present and future (including in each Fiscal Year, Principal Installments but not Super Sinker Redemptions) on all Senior Bonds, assuming that all Principal Installments have been and will be paid on their scheduled Principal Installment Payment Dates.

Amounts on deposit in the Liquidity Reserve Account will be available to pay interest on the Senior Bonds and to pay Principal Installments, to the extent Collections are insufficient for such purposes. Amounts in the Liquidity Reserve Account will not be available to make Super Sinker Redemptions or Extraordinary Prepayments. Amounts withdrawn from the Liquidity Reserve Account will be replenished from Collections as described herein.

Optional Redemption . . . . The Series 2002-1 Bonds maturing on or before July 15, 2012 are not subject to redemption at TSASC's option prior to their respective Principal Installment Payment Dates. The Series 2002-1 Bonds maturing on or after July 15, 2013 are subject to redemption at TSASC's option at any time on or after July 15, 2012, in whole or in part, at a redemption price of 100% of the principal amount thereof. All Series 2002-1 Bonds are subject to redemption without premium from sources other than Collections on or after their respective Super Sinker Redemption Dates or Principal Installment Payment Dates. TSASC may select dates, amounts, interest rates and maturities of Series 2002-1 Bonds for optional redemption at its sole discretion.

Trapping Account . . . . An additional reserve account (the "**Trapping Account**") has been established under the Indenture. The Trapping Account is held by the Indenture Trustee and will be funded pursuant to the Indenture following the occurrence of a Trapping Event. "**Trapping Event**" means a Consumption Decline Trapping Event, a Downgrade Trapping Event, a Lump Sum Trapping Event, a Model Statute Trapping Event or an NPM Trapping Event. "**Trapping Requirement**" means the greatest of the Consumption Decline Trapping Requirement, the Downgrade Trapping Requirement, the Lump Sum Trapping Requirement, the Model Statute Trapping Requirement or the NPM Trapping Requirement. "**Trapping Amount**" means (i) a fraction of the money available, prior to the deposit for Junior Payments (as hereinafter defined), equal to the ratio of the initial principal amount of previously issued Program Bonds to $2.76 billion, or (ii) in the event of a Lump Sum Trapping Event only, the lump sum, or (iii) with respect to a Trapping Event that is not in effect, zero.

"**Consumption Decline Trapping Event**" means shipments of cigarettes in or to the 50 United States, the district of Columbia and Puerto Rico are less in any year preceding a Deposit Date (as defined herein) than the shipment numbers set forth under "SECURITY—Accounts—Trapping Account" herein. "**Consumption Decline Trapping Requirement**" means 25% of the principal amount of the Outstanding Program Bonds until (i) two years after the end of a Consumption Decline Trapping Event of no more than two years' duration or (ii) three years after the end of a Consumption Decline Trapping Event of more than two years' duration, and thereafter zero.

"**Downgrade Trapping Event**" means, as of any Deposit Date, that an OPM with a Market Share (as defined in the MSA) of 7% or more in the calendar year preceding such Deposit Date is rated (or if such OPM is not rated, whose parent corporation is rated) below Baa3 by Moody's or BBB– by S&P. "**Downgrade Trapping Requirement**" means 25% of the principal amount of Outstanding Program Bonds until one year after the end of a Downgrade Trapping Event, and thereafter zero, and in any event zero if the applicable OPM has assumed the MSA in bankruptcy and is current on all MSA payments.

"**Lump Sum Trapping Event**" means the receipt of a lump sum in lieu of future TSRs that causes (or is expected to cause, as evidenced by an officer's certificate of TSASC) the amount available prior to the deposit for Junior Payments in a fiscal year to exceed the sum of the amounts (excluding any such lump sums) that were so available over the three preceding Fiscal Years. "**Lump Sum Trapping Requirement**" means the lump sum until there has occurred a twelve-month period, commencing at least twelve months after the most recent Lump Sum Trapping Event, in which the Trapping Account was at no point reduced below the Lump Sum Trapping Requirement and thereafter zero.

"**Model Statute Trapping Event**" means, as of any Deposit Date, that (a) the aggregate Market Share of the NPMs exceeds 3% in the calendar year preceding such Deposit Date and (b) the Model Statute (as hereinafter defined) is found to be invalid (i) in the New York Supreme Court or United States District Court in the State of New York and an appeal of such finding has not been filed within three months or after such three month period the finding of such court has not been stayed or (ii) in 25 states that in aggregate account for at least 50% of the payments under the MSA or (iii) by an appellate court having jurisdiction over New York on federal or New York State law or (iv) on federal grounds in any United States Court of Appeals. "**Model Statute Trapping Requirement**" means 25% of the principal amount of the Outstanding Program Bonds until one year after the end of a Model Statute Trapping Event, and thereafter zero.

"**NPM Trapping Event**" means, as of any Deposit Date, that the aggregate Market Share of the NPMs exceeds 7% in the calendar year preceding such Deposit Date. "**NPM Trapping Requirement**" means the lesser of (i) 6% of the principal amount of Outstanding Program Bonds for each full percentage point by which the aggregate Market Share of the NPMs exceeds 7% and (ii) 65% of such principal amount, which amount, as calculated immediately prior to the NPM Trapping Event ceasing to be in effect, shall remain the same for one year and thereafter shall be zero.

Following the occurrence of a Trapping Event, amounts that otherwise would have been paid in respect of Junior Payments or on the Residual Certificate will be deposited in the Trapping Account to the extent required by the Indenture and will be available to pay interest, Principal Installments, Super Sinker Redemptions and Extraordinary Prepayments on the Senior Bonds, in that order.

Amounts in the Trapping Account in excess of the Trapping Requirement on any Distribution Date will be transferred into the Collection Account.

Events of Default; Extraordinary Prepayment	The occurrence of any of the following events will constitute an "**Event of Default**" under the Indenture: (i) the failure by TSASC to pay when due interest on the Senior Bonds or certain BANs or the failure by TSASC to pay any Principal Installment of the Senior Bonds when due, (ii) the failure by TSASC to observe or perform any other provision of the Indenture which is not remedied within 30 days after notice thereof and which a majority in interest of the holders of the Senior Bonds determines should constitute an Event of Default, (iii) the institution of bankruptcy, reorganization, arrangement or insolvency proceedings by TSASC which are not dismissed within 60 days or (iv) the failure by the City to observe or perform its covenant to not limit or alter the rights of TSASC necessary to fulfill the terms of TSASC's agreements with the holders of the outstanding Bonds under the Indenture, or in any way impair the rights and remedies of such holders or the security for the Bonds and which failure is not remedied within 30 days after notice thereof and a majority in interest of the holders of the Senior Bonds determines such failure should constitute an Event of Default. Upon the occurrence of an Event of Default, the outstanding Senior Bonds will be prepaid on succeeding Distribution Dates in an amount equal to the available funds on deposit in the Extraordinary Prepayment Account (as described below) and the Trapping Account, without premium (any resulting prepayment of a Senior Bond prior to the relevant Super Sinker Redemption Date, or Principal Installment Payment Date with respect to those Senior Bonds which are not subject to Super Sinker Redemptions, is referred to herein as an "**Extraordinary Prepayment**").
Extraordinary Prepayment Account	If an Event of Default has occurred, on each Deposit Date after the payment of (i) certain expenses, (ii) all current and past due interest on the Senior Bonds, (iii) all current and past due Principal Installments, (iv) all current and past due Super Sinker Redemptions and (v) the replenishment of the Liquidity Reserve Account, Collections will be deposited in the Extraordinary Prepayment Account and applied to Extraordinary Prepayments of the Senior Bonds in order of their maturity on succeeding Distribution Dates.
Distributions and Priorities	The Indenture Trustee will deposit the Collections in the Collection Account. Amounts deposited during the period January 1 through June 30 in any Fiscal Year (each period from July 1 through the following June 30, a "**Fiscal Year**") will be applied to expenses and debt service requirements on the Bonds for the current and the next Fiscal Year. Amounts, if any, deposited during the period July 1 through December 31 in any Fiscal Year will be applied to expenses and debt service requirements on the Bonds for the current Fiscal Year.

Not later than five Business Days following each deposit of TSRs to the Collection Account (each, a "**Deposit Date**"), the Indenture Trustee will withdraw Collections on deposit in the Collection Account (to the extent Collections are in excess of amounts required to pay Trustee fees and expenses), and transfer such amounts as follows:

(i) to TSASC an amount specified by officer's certificate not to exceed $1,000,000 (adjusted for inflation as described herein) for each Fiscal Year, plus any arbitrage and rebate penalties, plus the amount necessary to provide for payment of certain credit enhancement and liquidity provider fees, if any, in each case for the current Fiscal Year and if the Deposit Date is between January 1 and June 30, for the following Fiscal Year;

(ii) to the Debt Service Account an amount sufficient to cause the amount on deposit therein to equal interest due (including interest at the stated rate on principal of Outstanding Bonds and on overdue interest, if any) on the Senior Bonds on the next succeeding Distribution Date, plus parity interest on BANs, swap payments and interest on variable-rate Senior Bonds due during the Semiannual Period including such Distribution Date, together with any such interest and payments unpaid from prior Distribution Dates;

(iii) to the Debt Service Account an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (ii) above) to equal the Principal Installments due during the current Fiscal Year and any past due Principal Installments and, if the Deposit Date is during the period from January 1 through June 30 of any year, the Principal Installments due during the next Fiscal Year;

(iv) to replenish the Liquidity Reserve Account until the amount on deposit therein equals the Liquidity Reserve Requirement;

(v) to the Debt Service Account an amount which, together with the amount deposited pursuant to clause (ii) above (but without regard to amounts on deposit therein pursuant to clause (iii) above), will cause the amount therein to equal interest on the Senior Bonds, parity interest on BANs and swap payments, in each case due (a) during the current Fiscal Year and, (b) if the Deposit Date is during the period from January 1 through June 30 of any year, during the next Fiscal Year (or, in the case of interest on variable-rate Senior Bonds, interest on BANs and swap payments, during the last complete Semiannual Period in such next Fiscal Year), assuming that principal payments will be made on the Bonds in the amounts deposited pursuant to clause (iii) above and clause (vi) below;

(vi) to the Debt Service Account an amount which, together with the amount deposited pursuant to clause (iii) above (but without regard to amounts on deposit therein pursuant to clauses (ii) and (v) above), will cause the amount therein to equal the Super Sinker Redemptions due during the current Fiscal Year and any past due Super Sinker Redemptions and, if the Deposit Date is during the period from January 1 through June 30 of any year, the Super Sinker Redemptions due during the next Fiscal Year;

(vii) if an Event of Default has occurred, to the Extraordinary Prepayment Account all amounts remaining;

(viii) if a Trapping Event has occurred and is continuing, to the Trapping Account the lesser of the Trapping Amount or the amount necessary to make the amount therein equal to the Trapping Requirement;

(ix) in the amounts and to the accounts specified by Series Supplement for payments on Subordinate Bonds, termination and certain other payments on swaps, term-out and subordinate payments with respect to credit enhancement, subordinate payments of interest and principal of BANs and any other subordinate payments specified by the Indenture (collectively, the "**Junior Payments**"); and

(x) to TSASC to pay Operating Expenses other than those paid under clause (i) above, if any, specified by officer's certificate.

For purposes of calculating amounts required to be deposited in the Debt Service Account, swap payments and interest on variable-rate Senior Bonds will be assumed at the maximum rate specified by Series Supplement payable on such Senior Bond or swap, and money so deposited will be transferred to the Collection Account pursuant to officers' certificates of TSASC reporting accruals at lower rates.

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

(i) from the Collection Account, to the Trustee, to pay Trustee fees and expenses pursuant to the Indenture;

(ii) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay interest (including interest at the stated rate on principal of Outstanding Bonds and on overdue interest, if any) on the Senior Bonds, parity interest on

BANs and swap payments due on such Distribution Date, plus any such unpaid interest and payments from prior Distribution Dates;

(iii) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay the Principal Installments due on such Distribution Date and any past due Principal Installments;

(iv) from the Liquidity Reserve Account, any amount remaining in excess of the Liquidity Reserve Requirement, to the Collection Account;

(v) from the Debt Service Account and the Trapping Account, in that order, in the amount required to make Super Sinker Redemptions due on such Distribution Date and any past due Super Sinker Redemptions;

(vi) from the Extraordinary Prepayment Account and the Trapping Account, in that order, if an Event of Default has occurred, to pay Extraordinary Prepayments on Senior Bonds;

(vii) from the Trapping Account, any amount remaining in excess of the Trapping Requirement, to the Collection Account;

(viii) from the accounts therefor, to make Junior Payments;

(ix) from the Collection Account, to pay Operating Expenses specified by officer's certificate of TSASC; and

(x) from the Collection Account, any amounts remaining to the holder of the Residual Certificate.

Collections and Reserves will be allocated among the various Series of Bonds according to the foregoing priority of payments and on a pro rata basis, as described under the caption "SECURITY—Flow of Funds."

Covenants .... Both TSASC and the City have made certain covenants for the benefit of the Bondholders. See "THE INDENTURE" for a summary of the covenants made by TSASC and "THE TSR PURCHASE AGREEMENT" for a summary of the covenants made by the City.

Ratings .... The ratings for the Series 2002-1 Bonds address only the ability of TSASC to pay interest and Principal Installments when due, and do not address the payment of principal at any faster rate, including any Super Sinker Redemptions. The ratings do not address the occurrence of future events, including the issuance of additional Program Bonds. A security rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time. See "RISK FACTORS—Limited Nature of Ratings; Reduction, Suspension or Withdrawal of a Rating."

Legal Considerations	Reference is made to "LEGAL CONSIDERATIONS" for a description of certain legal issues relevant to an investment in the Series 2002-1 Bonds.
Risk Factors	Reference is made to "RISK FACTORS" for a description of certain considerations relevant to an investment in the Series 2002-1 Bonds.
Tax Matters	Interest on the Series 2002-1 Bonds is not includable in the gross income of the owners of such Bonds for purposes of federal, New York State or New York City income taxation. See "TAX EXEMPTION AND OTHER TAX MATTERS".
TSASC Contact	Mr. Raymond Orlando Manager of Investor Relations Phone: (212) 788-5875 Fax: (212) 788-9197 E-mail: orlandor@omb.nyc.gov

INTRODUCTORY STATEMENT

This Offering Circular sets forth information concerning the issuance by TSASC of the Series 2002-1 Bonds in the aggregate principal amount of $500,000,000. The Series 2002-1 Bonds are a Series of parity Senior Bonds of TSASC and will be issued pursuant to the Indenture and the Series 2002-1 Supplement. Under the Indenture, TSASC may issue up to an aggregate principal amount of approximately $2.8 billion of Program Bonds without Rating Confirmation, depending on actual Debt Service at the time of issuance, if certain criteria are met. See "THE SERIES 2002-1 BONDS—Additional Series of Bonds" and "RATINGS" herein. Each Series of Senior Bonds (including any Program Bonds) is and will be on a parity with each other Series of Senior Bonds. Upon the issuance of the Series 2002-1 Bonds, approximately $1.228 billion principal amount of Senior Bonds will be outstanding.

TSASC is a special purpose, bankruptcy-remote local development corporation organized under the Not-For-Profit Corporation Law of the State and is an instrumentality of, but separate and apart from, the City. The board of directors of TSASC consists of not less than five nor more than seven directors, a majority of whom are and will be officials of the City. For additional information regarding the organization and management of TSASC, see "TSASC, INC." herein.

Pursuant to the TSR Purchase Agreement, TSASC has purchased all of the right, title and interest of the City under the MSA and the Decree, including the City's rights to receive its portion of the TSRs paid by PMs. The MSA, which was entered into on November 23, 1998, resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the PMs from past, present and future smoking-related claims, and provides for a continuing release of future smoking-related claims, in exchange for payments to be made to the Settling States as well as, among other things, certain tobacco advertising and marketing restrictions. Under the MSA, the State is entitled to 12.7620310% of the Initial Payments and Annual Payments made by the PMs under the MSA. The Decree allocates this statewide entitlement among the State, the City and certain other counties within the State. Under the Decree, the City has been allocated 26.670% of the statewide share of the Initial Payments and Annual Payments made by the PMs under the MSA (or approximately 3.40% of the nationwide settlement). Under the Indenture, TSASC has assigned and pledged its share of the TSRs to the Indenture Trustee to secure the Bonds. See "THE INDENTURE" and "THE TSR PURCHASE AGREEMENT" herein.

Pursuant to an escrow agreement established in conjunction with the MSA, payments of TSRs by the PMs under the MSA are made to the MSA Escrow Agent, which in turn disburses the funds so received to the Settling States. The State and the City have issued irrevocable instructions informing the MSA Escrow Agent that the TSRs payable to the City under the Decree have been sold to TSASC pursuant to the TSR Purchase Agreement, and directing the MSA Escrow Agent to disburse such TSRs directly to the Indenture Trustee. Accordingly, the TSRs to which TSASC is entitled are paid directly to the Indenture Trustee by the MSA Escrow Agent, do not pass through either the State or the City, and are not subject to State or City appropriation. See "SUMMARY OF THE MSA" and "NEW YORK CONSENT DECREE" herein.

The Series 2002-1 Bonds will be secured upon issuance thereof, together with all other Senior Bonds issued or to be issued, by a perfected first-priority security interest in, and pledge of, TSASC's tangible and intangible assets, including its right to receive a portion of the Initial Payments and Annual Payments under the MSA and the Decree. The Series 2002-1 Bonds do not constitute debt of the State or the City, and neither the State nor the City is liable thereon. TSASC does not have the power to pledge the credit, the revenues or the taxing power of the State or the City, and neither the credit, nor the revenues nor the taxing power of the State or the City is, or shall be deemed to be, pledged to the payment of any of the Bonds. TSASC has no taxing power.

Interest on the Series 2002-1 Bonds will be payable on each January 15 and July 15, commencing January 15, 2003. Principal of the Series 2002-1 Bonds will be paid according to the schedules of Principal Installments and Super Sinker Redemptions as described under "THE SERIES 2002-1 BONDS" herein. Certain methodologies and assumptions were utilized to establish the Principal Installments and Super Sinker Redemptions for the Series 2002-1 Bonds as described under "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. The amount and timing of payments on the Series 2002-1 Bonds may be affected by various factors. See "RISK FACTORS" herein.

RISK FACTORS

Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2002-1 Bonds as well as other information contained in this Offering Circular. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2002-1 Bonds, and does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2002-1 Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2002-1 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 2002-1 Bonds. There can be no assurance that other risk factors will not become material in the future.

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

Smoking Trends. As discussed in the DRI•WEFA Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to 419 billion cigarettes in 2001. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The DRI•WEFA Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.69% to 210 billion cigarettes in 2042 under its Base Case Forecast (as defined herein), which represents a decline in adult per capita consumption at an average rate of 2.48% 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 DRI•WEFA. A decline in the overall consumption of cigarettes beyond the levels forecasted in the DRI•WEFA Report could materially reduce the payments by PMs under the MSA and the amounts available to TSASC to pay principal of and interest on the Bonds.

Regulatory Restrictions and Legislative Initiatives. The tobacco manufacturers and tobacco products are the subject of numerous regulations and legislative proposals seeking, among other things, to impose liability upon the industry, further regulate the industry, prohibit public smoking and regulate labeling or advertising of cigarettes. 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. Cigarettes are currently subject to substantial excise taxes in the United States. The federal excise tax per pack of 20 cigarettes is $.39. All states and the District of Columbia currently impose taxes at levels ranging from $.025 to $1.50 per pack of cigarettes. According to the DRI•WEFA Report, up to 30 states have recently increased or are considering increases in excise taxes as a response to budget shortfalls. In addition, certain municipalities also impose an excise tax on cigarettes, ranging up to $1.50 per pack. These tax increases and other legislative or regulatory measures have severely increased the cost of cigarettes and could limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. Without limiting the generality of the foregoing, on August 9, 2000, the United States Surgeon General issued a report entitled "Reducing Tobacco Use: A Report of the Surgeon General" which advocates that significant increases in excise taxes on cigarettes would have a considerable impact on the prevalence of smoking and, in the long term, reduce the adverse health effects caused by tobacco. The Commonwealth of Massachusetts has enacted legislation to require cigarette manufacturers to report the flavorings and other ingredients used in each brand of cigarettes sold in the Commonwealth, and on a qualified, by-brand basis to provide "nicotine-yield ratings" for their products sold based on standards established by the Commonwealth. Cigarette manufacturers sued to have the statute declared unconstitutional, arguing that it could result in the public disclosure of valuable proprietary information. In September 2000, the district court granted the cigarette manufacturers' motion for summary judgment and permanently enjoined the Commonwealth of Massachusetts from requiring cigarette manufacturers to disclose brand-specific information on ingredients in their products. On October 16, 2001, in *Philip Morris v. Reilly*, 267 F.3d 45 (1st Cir. 2001), the United States Court of Appeals for the First Circuit reversed the district court and reinstated the statute, declaring it a valid exercise of the "police power" of the Commonwealth. The First Circuit subsequently withdrew its opinion and granted a rehearing to again address the takings and due process arguments which had previously been dismissed. Arguments took place on January 7, 2002 and a decision is pending. New York state law requires cigarettes to be "self-extinguishing" beginning in 2003. Similar legislation has been proposed (but not adopted) from time to time in other states and localities and at the federal level. Another statute, which was intended to become effective in the State in November 2000, prohibited the shipment or delivery of cigarettes to any person in the State who is not a licensed cigarette tax agent, wholesale or retail dealer or export warehouse proprietor. The statute would have banned mail order, internet and telephone cigarette sales directly to consumers in the State. One OPM and one SPM filed suit in a federal district court in the State seeking to overturn the statute, alleging that it is an unconstitutional interference with commerce. In June 2001, a federal district court judge declared the statute unconstitutional and permanently enjoined enforcement of the statute. As a result of these types of initiatives and other measures, the overall consumption of cigarettes may decrease materially more than forecasted in the DRI•WEFA Report and thereby have a material adverse effect on the amounts available to TSASC to pay principal of and interest on the Bonds. See "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, some of which are material. Such adjustments could reduce the TSRs distributable to TSASC below the respective amounts required to pay principal of and interest on the Senior Bonds. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MSA" herein.

The assumptions used to project Collections (the source of the payments on the Senior 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 Volume Adjustment. The assumptions used to project Collections and structure the Senior Bonds contemplate declining consumption of cigarettes in the United States combined with a static relative market share of 1.5%* for the NPMs. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. Should the forecasted decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments by the PMs due to application of the Volume Adjustment. One NPM has announced that it has developed a tobacco product with virtually no nicotine. This NPM could use the product to capture market share causing a reduction in Annual Payments. In addition, if people used the product to quit smoking, it could reduce the size of the 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. Because the price of cigarettes is a factor affecting consumption, NPM cost advantage could result in their increasing market share at the expense of the OPMs and SPMs. A significant loss of market share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and on the amounts available to TSASC to pay principal of and interest on the Senior Bonds. See "SUMMARY OF THE MSA— Adjustments to Payments" and "DRI•WEFA REPORT" herein.

NPM Adjustment. The NPM Adjustment is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and is designed to reduce the payments of the PMs under the MSA to compensate the PMs for losses in market share to NPMs during a calendar year as a result of the MSA. The adjustment is to be applied against the subsequent year's payments due to those Settling States that do not qualify for an exemption. See "SUMMARY OF THE MSA—Adjustments to Payments" herein.

In general, any state that adopts, maintains and diligently enforces a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA attempts to define what activities, if undertaken by a Settling State,

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* The aggregate market share of NPMs utilized in the bond structuring assumptions may differ materially from the market share information utilized by the MSA Auditor in calculating the NPM Adjustment. See "SUMMARY OF THE MSA - Adjustment to Payments - Non-Participating Manufacturers Adjustment."

would constitute diligent enforcement. Furthermore, it is unclear which party bears the burden of proving or disproving diligent enforcement by the Settling States. In January 2002, B&W disputed the recalculation of the Annual Payments due in 2000 and 2001, claiming that PricewaterhouseCoopers LLP, the independent auditor appointed under the MSA (the "**MSA Auditor**"), relied upon inappropriate data in calculating B&W's market share and that a larger NPM Adjustment should have been applied to the 2001 payment because a majority of the Settling States were not diligently enforcing their Qualifying Statutes in 2000. In April 2002, the National Association of Attorneys General ("**NAAG**") in a public release reported that B&W had agreed to release approximately $204 million previously deposited in the Disputed Payments Account for payment to the Settling States. In press reports, B&W stated that it was doing so at that time because it believed the data on which recalculation of the disputed Annual Payments was based were more reliable. The NAAG release did not indicate whether B&W continues to allege that a majority of the Settling States were not diligently enforcing their Qualifying Statutes.

In February 2002, the State received a letter from B&W, addressed to the Settling States' Attorneys General, requesting information relating to the enforcement of their applicable Qualifying Statute. The New York Attorney General's office believes that the State is diligently enforcing its Qualifying Statute. See "SUMMARY OF THE MSA—MSA Provisions Related to Model/Qualifying Statutes" herein.

Should a PM be entitled to an NPM Adjustment in future years due to non-diligent enforcement of the Qualifying Statute by the State, the NPM Adjustment could impair the flow of TSRs to TSASC. See "*Disputed or Recalculated Payments*" below. The structuring assumptions for the Bonds do not include any NPM Adjustments. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

Disputed or Recalculated Payments. Miscalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA could 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. Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). Certain of the Settling States and certain of the PMs are disputing the calculations of the Initial Payments which were due in January 2000, January 2001 and January 2002 and the Annual Payments which were due in April 2000, April 2001 and April 2002. As described above under "*NPM Adjustment*," B&W claimed that a larger NPM Adjustment should have been applied to the Annual Payment due in April 2001 because a majority of the Settling States were not diligently enforcing their Qualifying Statutes during calendar year 2000. B&W also challenged the appropriateness of the data used by the MSA Auditor in the recalculation of various payments. Since the Annual Payments due in April 2000 and April 2001 had already been paid by B&W, B&W claimed an offset against the Initial Payment due in January 2002 and deposited an amount equal to such offset in the Disputed Payments Account. In April 2002, NAAG in a public release reported that B&W had agreed to release approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States. The $204 million in the Disputed Payments Account was distributed to the Settling States with the Annual Payment due April 15, 2002. The resolution of disputed payments may result in the application of an offset against subsequent Initial Payments or Annual Payments. Both the diversion of disputed payments to the Disputed Payments Account and the application of offsets against future payments could materially impair the flow of TSRs to TSASC. The structuring assumptions for the Bonds do not factor in an offset for miscalculated or disputed payments. See "SUMMARY OF THE MSA—Adjustments to Payments—*Offset for Miscalculated or Disputed Payments*" herein.

Risks Related to Enforceability or Modification of the MSA and Constitutionality of the Model Statute

MSA Litigation. Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted litigation against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, certain of 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, barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed 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. In *Operating Engineers Local 12 Health and Welfare Trust Fund v. State of California*, the plaintiff is seeking moneys for medical expenses incurred as a result of tobacco use by union members and alleges that it attempted to be a party to the MSA but was rebuffed. This case is currently pending in the Los Angeles County Superior Court. An earlier suit brought by this plaintiff in the San Diego Superior Court was dismissed on the basis that the MSA foreclosed claims for healthcare reimbursement under the California Business and Professions Code. To date, such challenges have not been successful, although appeals are still possible in California and elsewhere. The terms of the MSA may continue to be challenged in the future. In the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. On June 17, 2002 trial court judge Charles E. Ramos, sitting in New York County, New York, entered an order on his own motion in *State of New York v. Philip Morris, Inc. et al*., the 1997 New York State lawsuit that was settled by the MSA. Citing unspecified ethical concerns relating to the 2001 award by arbitrators of attorneys' fees to lawyers representing the State of New York in connection with the MSA, Judge Ramos has ordered all interested parties to show cause why the court should not set aside the award of the arbitrators and take other action with respect to the attorneys and their fees. In so doing the court has also ordered interested parties to show cause why it should not vacate and set aside the York State Supreme Court's prior approval of the MSA. See also "*—Risks Inherent in Litigation*" and "*—Limited Remedies*" below. For a description of the opinion to be delivered to TSASC by Transaction Counsel with respect to the MSA, see "LEGAL CONSIDERATIONS—MSA Enforceability" herein.

Qualifying Statute. Under the MSA, downward adjustments are made to the Annual Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs, and the PM's participation in the MSA was a significant factor in such loss of market share. A Settling State may mitigate the effect of this adjustment by adopting and enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA), and the New York Attorney General's office believes that it is diligently enforcing its Qualifying Statute. Two cases which challenged the enforceability of the MSA, brought by importers and distributors in one case and by a manufacturer in the other, also challenged the Model Statute adopted by other Settling States. The case brought by the importers and distributors has been dismissed with prejudice. The case brought by the manufacturers has been dismissed by the trial court and that dismissal was affirmed on appeal. The plaintiff in that case has filed a petition for a writ of certiorari in the U.S. Supreme Court. Other cases have used an antitrust theory to challenge the Model Statute. *North American Trading Company and International Tobacco Partners, LLC v. "NAAG" et al.* ("North American"), was filed in the United States District Court for the District of Columbia on July 24, 2001. In this case, the plaintiff, an importer of foreign-made cigarettes, has alleged that importers and wholesalers of foreign-made cigarettes intended for resale in the United States are not Tobacco Product Manufacturers as defined in the Model Statute and have no substantial nexus to a particular state. The plaintiff requested an injunction to prevent the enforcement of the application of the Model Statute against it. On September 18, 2001, the District Court dismissed the case, and the plaintiffs have appealed. On July 1, 2002 *Grand River Enterprises Six Nations, Ltd. et al. v. William Pryor et al.* ("Grand River") was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the Model Statutes, including the New York Model Statute, violate their constitutional rights under the First and Fourteenth Amendments and the Commerce Clause of the Constitution and violate the Sherman Act on antitrust grounds. Although a determination that the Model Statute is unconstitutional would have no effect on the enforceability of the MSA itself, such a determination could have an adverse effect on payments to be made under the MSA if one or more NPMs were to gain market share in the future. For a description of the opinion to be delivered to TSASC by Transaction Counsel with respect to the Model Statute, see "LEGAL CONSIDERATIONS—Model Statute Constitutionality" herein.

Severability. Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. 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 MSA—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. TSASC is not a party to the MSA; accordingly, TSASC does not have 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 TSASC's ability to make payments to Bondholders. See "SUMMARY OF THE MSA—Amendments and Waivers" herein.

Reliance on State Enforcement. The State may not convey and has not conveyed to any of the City, TSASC, the Indenture Trustee or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled to a substantial portion of each Initial Payment and Annual Payment under the MSA, no assurance can be given that the State will enforce any particular provision of the MSA. Failure to do so may have a material adverse effect on TSASC's ability to make payments to Bondholders.

State Impairment. 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 Senior Bonds. See "LEGAL CONSIDERATIONS—Impairment of Contracts" herein.

Tobacco Industry Litigation

The tobacco industry has been the target of litigation for decades. 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 in the billions of dollars. 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 belonging to the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Individual Lawsuits. One OPM reported that as of May 1, 2002, there were approximately 1,500 active individual smoking and health cases pending in the United States against it and other tobacco industry defendants. Approximately 1,250 of these are pending before a single West Virginia state court in a consolidated proceeding that is set to begin in September 2002. In addition, one OPM reports that as of March 31, 2002, there were approximately 2,825 additional individual cases (referred to herein as the *Broin II* cases) filed primarily in Florida by individual current and former flight attendants claiming personal injury as the result of exposure to ETS in airline cabins. As of June 19, 2002, two individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. See "TOBACCO INDUSTRY—Civil Litigation—*Individual Plaintiffs' Lawsuits*" herein. In the last four years, there have been at least ten reported jury verdicts, including a 1996 jury verdict that was reinstated upon appeal, in individual smoking and health cases against the tobacco industry, including one or more PMs. The damages awarded in these cases have varied from $165,000 to $35 million in compensatory damages and up to $3 billion in punitive damages. Many of these verdicts have been appealed and final decisions are pending. On March 22, 2002, a Portland, Oregon jury awarded $168,000 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 award to

$100 million. Philip Morris has indicated that it will appeal the verdict. On February 22, 2002, a federal jury in Kansas City awarded $198,400 in compensatory damages to a former smoker in *Burton v. R.J. Reynolds Tobacco Co., et al.* The jury also determined that punitive damages were appropriate and, after a separate hearing was held to address that issue, the trial judge awarded the plaintiff $15 million in punitive damages. Both Reynolds Tobacco and B&W have stated they will appeal the verdict. On December 12, 2001, in *Kenyon v. R.J. Reynolds Tobacco Co.*, a Tampa, Florida jury awarded an individual plaintiff $165,000 in compensatory damages because Reynolds Tobacco had marketed a defectively designed product. Reynolds Tobacco has requested the court to overturn the verdict. On June 6, 2001, in *Boeken v. Philip Morris Incorporated, et al.*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product. The jury awarded the plaintiff $5.5 million in compensatory damages and $3.0 billion in punitive damages. The $3.0 billion punitive damages award has been reduced to $100 million post-trial. Philip Morris filed a notice of appeal from the award. 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 of 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 $1.0 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 for a tobacco-related illness. On June 29, 2001, the United States Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact. In 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. The plaintiff has appealed the new trial ruling. In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc., et al.* 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 have appealed the verdict. In April 1999, a Maryland jury in *Connor v. Lorillard, et al.* awarded $225,000 in compensatory damages and $2.0 million in punitive 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 1999, an Oregon jury in *Williams-Branch v. Philip Morris, et al.* awarded $821,500 in compensatory damages and $79.5 million in punitive damages (subsequently reduced by the trial judge to $32 million). The initial jury verdict was reinstated by an Oregon appellate court on June 5, 2002. Philip Morris has stated that it intends to seek to appeal the case to the Oregon Supreme Court. In February 1999, a California jury in *Henley v. Philip Morris, et al.* awarded $1.5 million in compensatory damages and $50 million in punitive damages (subsequently reduced by the trial judge to $25 million). On November 7, 2001, an appellate court affirmed the verdict. At the defendants' request, the California Supreme Court has decided to review the appellate court's decision.

Class Action Lawsuits. In addition to suits brought by individuals, plaintiffs have brought smoking and health lawsuits against the tobacco industry, including the PMs, as class actions. The MSA does not release the PMs from liability in class action lawsuits. The majority of state and federal courts which have heard such class action lawsuits have denied class certification due to the individual circumstances related to each smoker's election to smoke and the individual nature of the alleged harm. Nevertheless, classes have been certified and have withstood preliminary challenges in at least six states: California, Florida, Illinois, Louisiana, Massachusetts and West Virginia.

In *Engle v. R.J. Reynolds Tobacco Co., et al.*, 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 Phase I 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 Phase IIA, in April 2000, the same jury that heard Phase I awarded a total of $12.7 million in compensatory damages to the three named representative plaintiffs, finding that the defendant tobacco companies bore major responsibility for the plaintiffs' injuries. One OPM has requested that the court dismiss the award to one of the plaintiffs because of the jury's findings on a statute of limitations question. In July 2000, in Phase IIB, the same jury also assessed punitive damages of approximately $145 billion with respect to the entire class of possible plaintiffs. The punitive damages awarded against the OPM defendants are: Philip Morris, $73.96 billion; Reynolds Tobacco, $36.28 billion; B&W, $17.59 billion; Lorillard, $16.25 billion; and Liggett Group, Inc. ("**Liggett**"), $790 million. Phase III will determine compensatory damages for the remaining class members. The *Engle* tobacco industry defendants filed a motion to have the compensatory and punitive damage awards set aside or reduced or, in the alternative, for a new trial. The defendants removed the *Engle* case to federal court, and the federal judge heard arguments in November 2000 to determine whether the *Engle* class action would remain in federal court or be remanded to the state court in Florida. By order dated November 3, 2000, the United States District Court for the Southern District of Florida remanded *Engle v. Reynolds Tobacco, et al.* to the Eleventh Judicial Circuit of Dade County, Florida (the "**State Trial Court**"). On November 6, 2000, the State Trial Court issued its final judgment and order in which it (a) denied substantially all of the tobacco company defendants' pending and post-trial motions, including the motion for reduction of the $145 billion punitive damages award or, in the alternative, a new trial, and (b) entered the punitive damage award as a final judgment. On November 7, 2000, the defendants in *Engle* filed an appeal with respect to the entry of judgment, class certification and other reversible errors that they allege occurred during the trial. The appeal remains pending. The individual case of one *Engle* class member has gone to trial resulting in a jury verdict for compensatory damages against the tobacco industry defendants. The verdict cannot be enforced until the *Engle* appeal is decided.

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. 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 the amount of punitive damages, plus twice the statutory rate of interest, or 10% of a defendant's net worth, but in no case more than $100 million. Georgia, Kentucky, Louisiana, Nevada, North Carolina, Oklahoma, South Carolina, Virginia and West Virginia have enacted similar legislation. The Mississippi Supreme Court has also placed limitations on appeal bonds by court rule.

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, Liggett (the "**Stipulating Defendants**"), the plaintiffs, and the plaintiff class that provides the 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. Pursuant to the Stipulation, Philip Morris 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 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. See "TOBACCO INDUSTRY—Civil Litigation—*Class Action Lawsuits*" and "—*Risks Inherent in Litigation*" herein.

Healthcare Cost Recovery Lawsuits. Plaintiffs in these cases also seek compensatory and punitive damages in the billions of dollars. The plaintiffs include the United States and foreign governmental entities or others, such as labor unions, private companies, HMOs, hospitals, other third-party payers, native American tribes or private citizens suing on behalf of taxpayers who seek reimbursement of healthcare costs allegedly incurred as a result of smoking, as well as other alleged damages. One OPM has reported that as of May 1, 2002, there were 44 active healthcare cost recovery cases pending in courts in the United States against manufacturers of tobacco products, of which approximately ten were filed by union trust funds. One lawsuit, filed by the United States Department of Justice against the OPMs and other defendants, seeks to recoup unspecified damages pursuant to the Medical Care Recovery Act and the Medicare Secondary Payer Act for Medicare and other medical expenses allegedly incurred as a result of smoking-related illnesses, and to require defendants to disgorge profits pursuant to the federal Racketeer Influenced Corrupt Organizations (RICO) statute. The federal government has alleged that the tobacco companies have engaged in consumer fraud for failing to disclose health risks. On September 28, 2000 the district court ruled that the government could not use the Medical Care Recovery Act or the Medicare Secondary Payer Act to recover Medicaid expenses related to ill smokers and granted the defendants' motions to dismiss these claims. The district court also ruled that the government could proceed with its other claims under the RICO statute. The federal government has requested that the court reinstate the dismissed claims. The court denied that motion on January 31, 2001. In February 2001, the government filed an amended complaint attempting to replead the Medicare Secondary Payer Act claim. In July 2001, the court dismissed the amended complaint. In June 2001, the Department of Justice began to work on a possible settlement of the federal lawsuit. The Department of Justice met with representatives of the tobacco industry on July 18, 2001. No settlement was reached. In December 2001, the Department of Justice filed a pre-trial document setting forth some of the remedies it may seek in the lawsuit. In that document the Department of Justice indicated that it may seek severe limitations on the marketing and promotion of cigarettes. These limitations include requiring 50% of cigarette-pack surfaces to carry "graphic" health warnings and messages from the U.S. Surgeon General; requiring packs to carry health-leaflet inserts; eliminating slotting fees paid to retailers for favorable placement of tobacco products in stores; publicly disclosing manufacturing methods, marketing research, ingredients, additives and toxic chemicals; forbidding "light," "low-tar" or "mild" labels; banning vending machine sales; ending trade promotions and give-aways; and restricting all cigarette advertising to black-and-white-only formats, with 50% of the space dedicated to "graphic" health warnings. Trial is scheduled for July 2003 for the remaining RICO claim. In addition, foreign governmental entities, union, health and welfare funds, hospitals and insurers are seeking reimbursement of healthcare expenditures allegedly caused by tobacco products. Several foreign countries or subdivisions thereof have filed actions in Florida state courts to recover the costs of treating persons with diseases associated with tobacco use. The tobacco companies removed the cases to Federal District Court, and the cases were transferred to the United States District Court for the District of Columbia. The District Court remanded the cases brought by Venezuela, Ecuador, and the Brazilian states of Espirito Santo and Goias to Florida State Court. In April 2002, in *Republic of Venezuela v. Philip Morris Incorporated*, the United States Circuit Court for the D.C. Circuit refused to review the remand decision for lack of appellate jurisdiction. The Circuit Court also refused to prohibit the District Court from remanding similar cases brought by Russia and the Brazilian State of Mato Grosso Do Sol. The Florida Court has dismissed the Venezuela and Espirito Santo cases. In June 2001, a federal jury in the Eastern District of New York awarded Empire Blue Cross \$17.8 million in compensatory damages for violations of consumer protection statutes and \$11.8 million for separate but overlapping claims. In February 2002, the court granted plaintiffs' counsel's request for recovery of fees in the approximate amount of \$37.8 million. See "TOBACCO INDUSTRY—Civil Litigation—*Healthcare Cost Recovery Lawsuits*" below.

Other Tobacco-Related Litigation. One or more PMs are also defendants in other litigation stemming from the production, sale or use of tobacco products. These cases include lawsuits brought by former asbestos manufacturers now seeking contribution or reimbursement for amounts they expended in connection with the defense of claims and payment of damages for asbestos injury allegedly caused, in whole or in part, by cigarette smoking. They also include cases by smokers alleging that the marketing of tobacco products involves deceptive and unfair trade practices. These cases seek injunctive and equitable relief, including restitution. In addition, certain PMs and/or their affiliates have been sued in foreign courts. For example, the European Community ("**EC**") brought suit against Reynolds Tobacco and Philip

Morris alleging that the defendants engaged in a conspiracy to smuggle cigarettes into EC member states in an effort to evade taxes. On July 18, 2001, the U.S. District Court for the Eastern District of the State found that the EC claims were without merit and dismissed the case, stating that the EC had been unable to prove "that it has suffered any injury as a result of the defendants' illegal acts." On August 6, 2001, the EC and ten member states filed a complaint in the same court against RJR Nabisco, Inc. (Reynolds Tobacco's parent), Philip Morris and related companies. The EC complaint is essentially a resubmission of the first complaint filed on November 3, 2000. The second complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. On February 19, 2002, the court dismissed the case, stating that the tobacco companies were immune to liability by foreign governments for unpaid taxes in U.S. courts. The Plaintiffs have appealed. See "LEGAL CONSIDERATIONS" and "TOBACCO INDUSTRY—Civil Litigation—*Other Tobacco-Related Litigation*" herein.

Risks Inherent in Litigation. Ultimately, the outcome of pending litigation against the tobacco industry and any other pending or future smoking and health or other lawsuits is uncertain. No assurance can be given that the tobacco industry defendants will not at some point in the future incur additional liability for substantial judgments. One or more adverse judgments could result in a decision by affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the DRI•WEFA Report. See "DRI•WEFA REPORT" herein. Substantial compensatory or punitive damages, if awarded, whether singly or in the aggregate, could, as to any or all of the PM defendants, materially adversely affect their financial condition and thus impair their continued ability to make payments under the MSA. Any one or more of these possibilities could materially adversely affect the payment of TSRs to TSASC and impair the payments required to be made to Bondholders. For a further discussion of these matters, see "TOBACCO INDUSTRY—Civil Litigation" and "LEGAL CONSIDERATIONS" herein.

Bankruptcy of a PM May Delay or Reduce Payments

Title 11 of the United States Code (the "**Bankruptcy Code**") may affect the ability of the State to enforce its rights under the MSA if a PM were to become a debtor under the Bankruptcy Code. For example, under the Bankruptcy Code, virtually all actions to collect money from the bankrupt are automatically stayed upon the commencement of the bankruptcy case and the bankrupt is prohibited during the pendency of the bankruptcy case from making most payments owed under a contract entered into by the bankrupt prior to the commencement of the bankruptcy case, unless payment is permitted by the bankruptcy court. Moreover, if it was 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 an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Accordingly, even if the bankrupt PM wanted to continue paying TSRs, it could be prohibited as a matter of law from making such payments and delays in payments under the MSA by the bankrupt PM would be likely, which could result in delays in, or reductions of amounts available for, payments of the Series 2002-1 Bonds and the other Senior Bonds. Bondholders could also incur a loss on their investment.

Other risks associated with the bankruptcy of a PM include the risk that (i) certain payments previously made to the Bondholders could be avoided as preferential payments, so that Bondholders would be required to return such payments to the bankrupt PM; (ii) the State may be unable to exercise remedies under the MSA; and (iii) the obligations of the bankrupt PM under the MSA may be modified. For example, if the PM rejects the MSA in bankruptcy, resulting in a claim in favor of the State (and, thus, the Indenture Trustee and the Bondholders through TSASC) for damages, the bankruptcy court may approve a plan of reorganization or liquidation of the bankrupt PM which alters the timing (for a longer or shorter period than payments on the Series 2002-1 Bonds) or the amount of payments to be made by the bankrupt PM in respect of the MSA. Additionally, the bankruptcy court may approve a reorganization or liquidation plan which provided for the State (and thus the Indenture Trustee and the Bondholders

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* The Bankruptcy Code does not specifically define "executory contract," but it is generally considered to be a contract in which performance remains due to some extent from both parties.

through TSASC) to receive a payment on account of its claim for damages resulting from rejection of the MSA in the form of property other than cash (such as securities). The absence of an enforceable Qualifying Statute could have an effect on the decision of a bankrupt PM to accept or reject the MSA. Finally, while certain provisions of the MSA purport to deal with the situation of a PM going 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 reduction in payments to the Bondholders. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered to TSASC by Transaction Counsel with respect to PM bankruptcy matters, see "LEGAL CONSIDERATIONS—Bankruptcy of a PM."

Recharacterization of the Transfer of TSRs as a Secured Borrowing Would Invalidate Sale of TSRs

The City is authorized by statute to file a voluntary petition for bankruptcy under the Bankruptcy Code. If the City were to become a debtor under the Bankruptcy Code, a creditor or the City might argue that the transfer of the TSRs from the City to TSASC was (or should be recharacterized as) a pledge to secure a borrowing rather than an absolute sale. A determination that the sale by the City of the TSRs was a secured borrowing by the City would invalidate such sale, since the City is not authorized to make such a secured borrowing. If the sale were invalidated, TSASC would have no source from which to pay the Bonds. If the transactions contemplated are treated as a sale, the TSRs would not be part of the City's bankruptcy estate and would not be available to the creditors of the City. For a fuller description of certain bankruptcy issues and a description of certain legal opinions to be delivered to TSASC by Transaction Counsel with respect to bankruptcy matters, see "LEGAL CONSIDERATIONS—Bankruptcy of the City" herein.

Substantive Consolidation of the City and TSASC May Result in Losses

TSASC and the City have taken and will take steps that are intended to ensure that a voluntary petition for relief by the City under the Bankruptcy Code will not result in the substantive consolidation of the assets and liabilities of TSASC with those of the City. Nevertheless, a court may determine that the activities of TSASC will result in the assets and liabilities of TSASC being substantively consolidated with those of the City in a bankruptcy or insolvency proceeding. Any such order would adversely affect TSASC's ability to receive TSRs, and Bondholders could therefore incur losses on their investment. For a fuller description of certain bankruptcy issues and a description of certain legal opinions to be delivered to TSASC by Transaction Counsel with respect to bankruptcy matters, see "LEGAL CONSIDERATIONS—Bankruptcy of the City" herein.

Uncertainty as to Timing of Amortization

No assurance can be given that Super Sinker Redemptions will be made on the scheduled Super Sinker Redemption Dates. The timing of Super Sinker Redemptions will be based primarily on TSASC's receipt of Collections. A certain level of Collections has been forecasted based on various assumptions including, among others, domestic cigarette consumption levels as set forth in the DRI•WEFA Report and adjustments to the payments by the PMs as required by the terms of the MSA. These assumptions are discussed in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein. Actual results will vary from the assumptions. Such variance could be material and could affect the level of Collections. A reduction in Collections below forecast levels would affect debt service coverage on the Series 2002-1 Bonds. If the reduction were material it could impair the ability of TSASC to make Super Sinker Redemptions or even its ability to pay Principal Installments as they become due. As a result, actual amortization may not conform to either the Principal Installments or the Super Sinker Redemptions.

Although TSASC has covenanted to make the Super Sinker Redemptions to the extent Collections are available, the Rating Agencies have not been asked to evaluate whether TSASC will receive Collections sufficient to enable it to make timely Super Sinker Redemptions. The ratings address the payment of interest and Principal Installments when due, and not payment of Super Sinker Redemptions. Investors should be aware that if TSASC pays Principal Installments in accordance with their scheduled

Principal Installment Payment Dates, the average life of the Series 2002-1 Bonds maturing July 15, 2024 and July 15, 2032 will be significantly longer than the average life of the Super Sinker Term Bonds if they were paid pursuant to the Super Sinker Redemptions. If TSASC is able to pay the Super Sinker Term Bonds in accordance with the Super Sinker Redemptions, the average life of the Super Sinker Term Bonds will be significantly shorter than if the Super Sinker Term Bonds were paid in accordance with their respective Principal Installments. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2002-1 Bonds will be borne entirely by the Bondholders.

Limited Resources of TSASC

The Series 2002-1 Bonds, and all other Bonds issued and to be issued by TSASC, are payable only from the assets of TSASC. In the event that the assets of TSASC have been exhausted, no amounts will thereafter be paid on the Series 2002-1 Bonds. The Series 2002-1 Bonds are not obligations of the City or the State, and no recourse may be had to either for payment of amounts owing on the Series 2002-1 Bonds. Investors in the Series 2002-1 Bonds must look solely to the assets of TSASC for repayment of their investment. TSASC's only source of funds for payments on the Series 2002-1 Bonds and all other Bonds issued and to be issued by it are the Collections, the Reserves and amounts on deposit in pledged accounts pursuant to the Indenture.

Limited Remedies

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

Limited Liquidity of the Series 2002-1 Bonds

While the Underwriters intend to make a secondary market in the Series 2002-1 Bonds they are under no obligation to do so. There can be no assurance that a secondary market for the Series 2002-1 Bonds will develop, or if a secondary market does develop, that it will provide Bondholders with liquidity or that it will continue for the life of the Series 2002-1 Bonds. Consequently, any purchaser of the Series 2002-1 Bonds must be prepared to hold such securities for an indefinite period of time.

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

Any rating assigned to the Senior Bonds of a Series by a Rating Agency will reflect such Rating Agency's assessment of the likelihood that Senior Bonds of such Series will receive timely payments of interest and Principal Installments. However, any such rating will not address the likelihood that the Super Sinker Redemptions will be made on each Super Sinker Redemption Date. The rating of the Senior Bonds of a Series will not be a recommendation to purchase, hold or sell such Senior Bonds and such rating will not address the marketability of such Senior Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if, in such Rating Agency's judgment, circumstances so warrant based on factors prevailing at the time, including, but not limited to, the evaluation by such Rating Agency of the financial outlook for the tobacco industry or the issuance of additional Series of Program Bonds. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market or the market price of the Bonds.

SUMMARY OF THE MSA

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

General

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

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 July 11, 2002, 34 SPMs have signed the MSA. The chart below identifies each of the PMs currently a party to the MSA:

OPMs	SPMs	
Brown & Williamson Tobacco Corporation	Alliance Tobacco Corp.	The Medallion Company, Inc.
Lorillard Tobacco Company	Caribbean-American Tobacco Corp. (CATCORP)	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
Philip Morris Incorporated	Commonwealth Brands, Inc.	P.T. Djarum
R.J. Reynolds Tobacco Company	Cutting Edge Enterprises, Inc.	Pacific Stanford Marketing Corporation
	Daughters & Ryan, Inc.	Peter Stokkebye International A/S
	Dhanraj International, Inc.	Planta Tabak-manufaktur GmbH & Co.
	Eastern Company S.A.E.	Poschl Tabak GmbH & Co. KG
	House of Prince A/S	Premier Manufacturing Incorporated
	Imperial Tobacco Limited/ITL (USA) Limited	Santa Fe Natural Tobacco Company, Inc.
	Japan Tobacco International U.S.A., Inc.	Sherman 1400 Broadway N.Y.C., Ltd.
	King Maker Marketing	Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes (Seita)
	Konci G&D Management Group (USA) Inc.	Tobacco & Candy International, Inc.
	Kretek International	Top Tobacco, LP
	Lane Limited	Vector Tobacco (USA) Ltd.
	Liggett Group Inc.	Virginia Carolina Corporation, Inc.
	Lignum-2, Inc.	Winner Sales Company
	Mac Baren Tobacco Company A/S	ZNF International, LLC

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

Scope of Release

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

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

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

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

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

Overview of Payments by the Participating Manufacturers

The MSA requires that the PMs make several types of payments, including Initial Payments and Annual Payments*. See "Initial Payments" and "Annual Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustment to Payments" below. SPMs are not required to make Initial

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

Payments. Thus far, the OPMs have made the up-front Initial Payment and the Initial Payments for 2000, 2001 and 2002, and the OPMs and other PMs have made the Annual Payments for 2000, 2001 and 2002 (subject to certain withholdings described in "RISK FACTORS — Other Potential Payment Decreases Under the Terms of the MSA" herein).

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

Initial Payments

Initial Payments are 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 final Initial Payment is due on or before January 10, 2003.

After the up-front Initial Payment made in 1998, the relative payment responsibilities of the OPMs are recalculated each year based on the OPM's Relative Market Share during the preceding calendar year. "**Relative Market Share**" is defined as an OPM's percentage share of the number of cigarettes shipped by all OPMs in or to the 50 states, the District of Columbia and Puerto Rico (defined hereafter as the "**United States**"), as measured by the OPM's reports of shipments to Management Science Associates, Inc. (or any successor acceptable to all the OPMs and a majority of the attorneys general of the Settling States who are also members of the NAAG executive committee). The term "**cigarette**" is defined in the MSA to mean any product that contains nicotine, is intended to be burned, contains tobacco and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco.

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 three Annual Payments due April 15, 2000, April 15, 2001 and April 15, 2002, the scheduled base amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion and $6.5 billion, respectively. After application of the adjustments, (i) the Annual Payment made in April 2000 was approximately $3.5 billion, (ii) the Annual Payment made in April 2001 was approximately $4.1 billion, and (iii) the Annual Payment made in April 2002 was approximately $5.2 billion. The scheduled base amount (before adjustments discussed below) of each Annual Payment, subject to adjustment, is set forth below:

Annual Payments

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

The 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.

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 Federal Tobacco Legislation Offset,
- the Litigating Releasing Parties Offset, and
- the Offset for Claims-Over.

Application of these adjustments resulted in material reductions of TSRs from the scheduled base amounts of the Annual Payments made by the PMs in April 2000, 2001 and 2002, as discussed below under the heading "Payments Made to Date."

Adjustments to Payments

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

Inflation Adjustment. The base amount of the Annual Payments are increased each year to account for inflation. The increase in each year will be 3% or a percentage equal to the percentage increase in the Consumer Price Index (the "**CPI**") (or such other similar measures as may be agreed to by the Settling States and the PMs) for the preceding year, whichever is greater (the "**Inflation Adjustment**"). The Inflation Adjustments are compounded annually on a cumulative basis beginning in 1999 and were first applied in 2000. Initial Payments are not subject to the Inflation Adjustment.

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

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

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

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

Non-Participating Manufacturers Adjustment. If the aggregate market share of the PMs in any year falls more than 2% below the aggregate market share held by those same PMs in 1997, and if a nationally recognized team of economic consultants determines that the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, an adjustment (the "**NPM Adjustment**") is applied to the Annual Payment due in the following year. The 1997 market share percentage for the PMs, less 2%, is defined as the "**Base Aggregate Participating Manufacturer Market Share**." If the PMs' actual aggregate market share is between 0% and 16⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs will be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16⅔%, the NPM Adjustment will be calculated as follows:

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

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and enforcing the Model Statute or a Qualifying Statute (as defined herein). Any Settling State that adopts and diligently enforces a Model Statute or Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment will not exceed 65% of the amount of such state's allocated payment. If a Qualifying 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 "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, the same terms will be extended to all PMs.

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

Federal Tobacco Legislation Offset. If federal tobacco-related legislation is enacted on or before November 30, 2002 and if such legislation provides for payments by any PM to the federal government all or part of which are actually made available to any Settling State, the MSA provides that each PM will receive a continuing dollar-for-dollar offset for such amounts paid to and received by such Settling State (the "**Federal Tobacco Legislation Offset**"). The Federal Tobacco Legislation Offset applies only to that portion of the federal funds directed to a Settling State that is either unrestricted as to its use or restricted to any form of healthcare or to any use related to tobacco.

The Federal Tobacco Legislation Offset does not generally apply to federal funds conditioned, or appropriately allocable, either to the relinquishment of rights or benefits under the MSA or to a consent decree or actions or expenditures by the Settling State. However, if the Settling State chooses to undertake such action or expenditure, and if such actions or expenditures either (i) do not impose significant constraints on public policy choices, or (ii) are both related to health or tobacco and do not require the Settling State to expend state matching funds in an amount that is significant in relation to the amount of federal funds made available to the applicable Settling State, the Federal Tobacco Legislation Offset applies. The Federal Tobacco Legislation Offset does not reduce the total amounts payable by the PM to the Settling States under the MSA by an amount greater than the amount of federal funds that the Settling States could elect to receive.

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

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

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments which are made at the same times as the Annual Payments to be made by OPMs. Annual Payments for SPMs are calculated differently, however, from Annual Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its "**Base Share**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. Seventeen of the current 34 SPMs signed the MSA on or before the February 22, 1999 deadline.

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

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

“Most Favored Nation” Provisions

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

In the event that any Settling State should reach a settlement of released claims with NPMs that provides more favorable terms to the NPM than the MSA does to the PMs, the terms of the MSA will be deemed modified to match the NPM settlement, but only with respect to the particular Settling State. In the event that any Settling State agrees to reduce the burden placed upon any PM by the terms of the MSA, the MSA will be deemed modified so that each PM enjoys the same reduction in burden, but only with respect to the particular Settling State. In no event will the adjustments discussed in this paragraph modify the MSA with regard to other Settling States.

State-Specific Finality and Final Approval

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

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

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

Disbursement of Funds From Escrow

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

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts shall occur within ten business days of receipt of the particular funds. The MSA Escrow Agent will disburse the funds due to, or as directed by, each Settling State in accordance with instructions received from that state. The Attorney General of the State of New York and the City have issued irrevocable instructions directing the MSA Escrow Agent to disburse the TSR’s directly to the Indenture Trustee. The moneys to which Tsasc is entitled do not pass through the State or the City and are not subject to appropriation by either.

Advertising and Marketing Restrictions; Educational Programs

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

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

Termination of Agreement

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

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

Severability

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

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

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

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

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

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

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

> [i]t would be contrary to the policy of the state if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the state will have an eventual source of recovery from them if they are proven

> to have acted culpably. It is thus in the interest of the state to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

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

The amounts deposited in the escrow accounts by the NPMs may only be used in limited circumstances. Although the NPM receives the interest or other appreciation on such funds, the principal may only be released (i) to pay a judgment or settlement on any claim of the type that would have been released by the MSA brought against such NPM by the applicable Settling State or any Releasing Party located within such state; (ii) to the extent that the NPM establishes that the amount it was required to deposit into the escrow account was greater than such state's allocable share of the total payments that such NPM would have been required to make if it had been a Participating Manufacturer under the MSA (as determined before certain adjustments or offsets); or (iii) 25 years after the date that the funds were placed into escrow (less any amounts paid out pursuant to clause (i) or (ii)).

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

The New York Qualifying Statute. The New York Qualifying Statute became effective on November 27, 1999. By agreement dated February 7, 2001, each of the OPMs has acknowledged that the New York Qualifying Statute, if maintained in its current form without modification or addition other than as agreed to by the PMs, is a Model Statute under the MSA (which means that it is also a Qualifying Statute).

NEW YORK CONSENT DECREE

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

Introduction and Overview

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

The Appellate Division affirmed the Decree in a unanimous decision dated July 15, 1999. The period in which to appeal the decision of the Appellate Division expired on August 16, 1999 without any request to appeal being served. The time for all appeals against the Decree has expired and the State achieved State-Specific Finality on August 17, 1999.

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

According to the formula set forth in the MSA, the State is entitled to 12.7620310% of the total amount deposited in the national escrow account. The allocation of the State's share of the Initial Payments and Annual Payments to be made pursuant to the MSA to the State, its counties and the City is set forth in the Decree, which provides that the State and the City are to receive 51.176% and 26.670%, respectively, of the Initial Payments and the Annual Payments. TSASC has purchased all of the City's right, title and interest in and to such payments pursuant to the TSR Purchase Agreement. Under the Indenture, TSASC has assigned and pledged the TSRs so purchased from the City to the Indenture Trustee to secure the Bonds. The State and the City have issued irrevocable instructions informing the MSA Escrow Agent that the TSRs payable to the City under the Decree have been sold to TSASC pursuant to the TSR Purchase Agreement, and directing the MSA Escrow Agent to disburse such TSRs directly to the Indenture Trustee. Accordingly, the TSRs to which TSASC is entitled are paid directly to the Indenture Trustee by the MSA Escrow Agent, do not pass through either the State or the City, and are not subject to State or City appropriation.

Rights to Enforce Provisions of the Consent Decree

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

Release and Dismissal of Claims

The Decree further provides that, effective upon the occurrence of State-Specific Finality in the State, the counties and the City unconditionally will release and discharge all released claims against all Released Parties to the same extent that the State released its claims pursuant to the MSA. The counties and the City agree that, after the occurrence of State-Specific Finality, they will not seek to establish civil liability against any Released Party upon any released claim and that such agreement will be a complete defense to any such civil action or proceeding.

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 publicly available analyses of the tobacco industry and other public sources. Certain of the companies file annual, quarterly and other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the Office of Public Reference of the SEC, 450 5th Street, NW, Room 1300, Washington, D.C. 20549-0102 (phone: (202) 942-8090; fax: (202) 628-9001; e-mail: publicinfo@sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although TSASC has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, TSASC *has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the Attorney General of the State of New York has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2002-1 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Bonds is consistent with their investment objectives.*

Retail market share information, based upon sales as reported by the OPMs, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Initial Payments, and the PMs to contribute to Annual Payments. The Relative Market Share information reported is confidential under the MSA. See "SUMMARY OF THE MSA—Initial Payments," and "—Annual Payments" herein. Additionally, aggregate market share information, based upon shipments as reported by Loews and reflected in the chart below entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that utilized in the bond structuring assumptions. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" herein.

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

Industry Overview

According to their own publicly available documents, the four leading manufacturers of tobacco products in the United States in 2001 collectively accounted for approximately 94% of domestic cigarette industry retail market share when measured by sales volume and for approximately 94% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the United States divides generally into premium and discount sales, approximately 74% and 26%, respectively, measured by volume of all domestic cigarette sales in 2001.

Philip Morris, a subsidiary of Philip Morris Companies Inc., is the largest tobacco company in the United States. On April 25, 2002, the shareholders of Philip Morris Companies Inc. granted the Company's Board of Directors the authority to change the name of the holding company to Altria Group, Inc. The Board retained the discretion to determine when to effect the name change. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2001, Philip Morris reported that its domestic retail market share based on sales in 2001 was 50.8%, which represents an increase of 0.3 share points from its self-reported 2000 domestic retail market share based on sales of 50.5%. For the quarter ended June 30, 2002, Philip Morris reported that its domestic retail market share based on shipments was 47.1%, which represents a decrease of 3.7 share points from the comparable period of 2001. Philip Morris' major premium brands are Marlboro, Virginia Slims, Parliament, Merit and Benson & Hedges. Its principal discount brands are Basic and Cambridge. Marlboro is the largest selling cigarette brand in the United States, with approximately 38.8% of the United States domestic retail share in 2001, and has been the world's largest-selling cigarette brand since 1972.

Reynolds Tobacco is the second largest tobacco company in the United States. In its Annual Report on Form 10-K filed by Reynolds Tobacco's parent company relating to its results for the year ended December 31, 2001, Reynolds Tobacco reported that its domestic retail market share in 2001 was 23.4% (measured by sales volume), which represents a decrease of 0.2 share points from its self-reported 2000 domestic retail market share. For the quarter ended June 30, 2002, Reynolds Tobacco reported that its domestic retail market share based on shipments was 23.9% which represents an increase of 1.1 share points from the comparable period of 2001. This market share information does not reflect the acquisition by Reynolds Tobacco of Santa Fe Natural Tobacco Company, Inc. which accounted for 0.3% market share based on shipments for the quarter ended June 30, 2002. Reynolds Tobacco's major premium brands are Winston, Camel, Salem and Vantage. Its discount brands include Doral, Monarch and Best Value.

B&W, with headquarters in Louisville, Kentucky, is a subsidiary of British American Tobacco p.l.c., a holding company based in London, England, and is the third largest tobacco company in the United States. According to publicly available documents on its website, B&W reported that its domestic retail market share based on sales in 2001 was 10.4% (measured by sales volume), which represents a decrease of 1.3 share points from its self-reported 2000 domestic retail market share. B&W's largest selling brand is GPC, a discount brand. Its other major brands are Kool, Carlton and Lucky Strike.

Lorillard, a wholly owned subsidiary of Loews, is the fourth largest tobacco company in the United States. On February 6, 2002, in an initial public offering, Loews issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews' stock in Lorillard. Carolina Group is not a separate legal entity. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2001, Lorillard's parent reported that its domestic retail market share in 2001 was 9.5% (measured by shipment volume), which represents a decrease of 0.3 share points from its self-reported 2000 domestic retail market share. In its Form 10-Q for the quarter ended March 31, 2002, Lorillard reported that its domestic retail share (based on shipments) was 9.5% which represents a decrease of 0.1 share points for the comparable period of 2001. Lorillard's major brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 85% of Lorillard's unit sales in 2001.

Based on the domestic retail market shares discussed above, the remaining share of the United States retail cigarette market in 2001 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett, a wholly owned subsidiary of Brooke Group, Ltd., the predecessor of Vector Group Ltd. Liggett, the operating successor to the Liggett & Meyers Tobacco Company, is the fifth largest tobacco company in the United States. In its Annual Report on Form 10-K for the year ended December 31, 2001, Liggett reported that its domestic retail market share in 2001 was 2.2% (measured by shipment volume), which represents an increase of 0.7 share points from its self-reported 2000 domestic retail market share. Liggett currently produces five premium brands: Lark, Eve, L&M, Chesterfield and Jade, in addition to certain discount brands including Pyramid. 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 has announced that it expects to introduce a nicotine-free cigarette under the brand name QUEST. Liggett and Vector Group Ltd. are SPMs under the MSA.

The following table sets forth the approximate comparative positions of the leading producers in the United States tobacco industry, each of which is an OPM under the MSA, based upon cigarette retail sales:

Manufacturers' Domestic Retail Market Share Based on Sales*

Manufacturer	1997	1998	1999	2000	2001
Philip Morris	51.0%	49.4%	49.9%	50.5%	50.8%
Reynolds Tobacco	25.4	25.2	23.9	23.6	23.4
B&W/American Brands	16.1	15.0	13.4	11.7	10.4
Lorillard	8.8	9.3	10.7	10.0	N.A.
Other**	—	1.1	2.1	4.2	N.A.

N.A. means not available.

* Totals may not equal 100% as the retail market shares of each of the OPMs has been obtained from their own publicly available documents. These amounts may differ from amounts reported by other OPMs.

** The retail market share 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 their own publicly available documents (noted above) from 100%. In 1997, the total retail market share of each of the OPMs as reported by their own publicly available documents, when aggregated, was in excess of 100%.

Shipment Trends

The following table sets forth the approximate comparative positions of the leading producers in the United States domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette shipments:

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	1997	1998	1999	2000	2001
Philip Morris	48.7%	49.4%	49.0%	48.7%	50.9%
Reynolds Tobacco	24.2	24.0	22.7	22.2	22.3
B&W/American Brands	16.0	15.0	13.2	11.3	10.9
Lorillard	8.7	9.1	10.3	9.3	9.5
Other**	2.4	2.5	4.8	8.5	6.4

* The shipment market shares of each of the OPMs has been obtained from publicly available documents of Loews. These amounts may differ from amounts reported by other OPMs.

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

The following table sets forth the industry's cigarette shipments in the United States for the five years ended December 31, 2001. The MSA payments are calculated in part on industry shipments rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
1997	482.9
1998	460.8
1999	419.3
2000	419.8
2001	406.3

* As reported in SEC filings and other publicly available documents of Philip Morris.

Both Philip Morris and Reynolds Tobacco reported for the quarter ended June 30, 2002 that industry shipments during the quarter decreased by 7.0%. Both attributed the decline in part to trade inventory depletions following April 2002 price increases and the timing of promotions. Philip Morris estimates that the industry volume continued to decline at an annualized rate of 1% to 2%.

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 Initial Payments and Annual Payments under the MSA.

Consumption Trends

According to an April 2002 estimate by the United States Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the United States consumed an estimated 422 billion cigarettes in 2001, which would represent a decrease of 1.9% from the previous year. Price increases and higher state taxes are the main factors cited for declining cigarette use. The following chart sets forth domestic cigarette consumption from 1997 through 2001:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)*
1997	480
1998	465
1999	435
2000	430
2001	422**

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

** Estimated, subject to change.

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 and where permitted by law, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

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

Gray Market

According to the USDA-ERS, during 1998 and 1999, the differential between the manufacturer's wholesale price and the export price of United States cigarettes created an opportunity for arbitrage. Independent traders exported United States manufactured cigarettes and then re-imported them into the United States, paying import duties and excise taxes. Because cigarettes sold for export are priced so low, it was possible to import cigarettes into the United States in this fashion and make a profit, while selling them at a lower price than cigarettes produced for the domestic market. In 1999, gray market imports were estimated at 3.0 to 4.5 billion pieces, less than 1% of total consumption. Legislation prohibiting gray market sales became effective in January 2000, and according to USDA-ERS, gray market sales are expected to cease.

Regulatory Issues

General. The manufacture, sale and use of tobacco continue to be the focus of numerous regulatory initiatives, both domestically and abroad. Among other things, these initiatives seek to ameliorate the adverse health effects associated with smoking and exposure to environmental tobacco smoke ("**ETS**"). Reports concerning the harmful physical effects of cigarette smoking and other forms of tobacco use have been publicized for many years, and the sale, promotion and use of cigarettes and other tobacco products continue to be the subject of increasing governmental and private sector regulation.

Federal Regulation. Since 1964, the Surgeon General of the United States and the Secretary of Health and Human Services have released a number of reports linking cigarette smoking to a broad range of health hazards, including various types of cancer, heart disease and chronic lung disease, and have recommended various governmental measures to reduce the incidence of smoking. Since 1965, federal law has required that health warnings be printed on each pack of cigarettes.

In recent years, various members of the United States Congress have introduced legislation, some of which has been the subject of hearings or floor debate, that would subject cigarettes to various regulations under the Department of Health and Human Services or regulation under the Consumer Products Safety Act, establish educational campaigns relating to tobacco consumption or tobacco control programs, or provide additional funding for governmental tobacco control activities, further restrict the advertising of cigarettes, require additional warnings, including graphic warnings, on packages and in advertising, eliminate or reduce the tax deductibility of tobacco advertising, provide that the Federal Cigarette Labeling and Advertising Act and the Smoking Education Act not be used as a defense against liability under state statutory or common law, and allow state and local governments to restrict the sale and distribution of cigarettes.

The Federal Trade Commission, which has regulated the manner in which cigarette manufacturers test and disclose the tar, nicotine, and carbon monoxide levels of cigarettes, has proposed revisions to the test methodology and reporting procedures established by a 1970 voluntary agreement among domestic cigarette manufacturers. In 1992, the adoption of the Federal Alcohol, Drug Abuse and Mental Health Act required states to adopt a minimum age of 18 for purchases of tobacco products and establish a monitoring system to prevent underage purchases. In 1992, the United States Environmental Protection Agency (the "**EPA**") issued a report that included a risk assessment of the relationship between ETS and lung cancer in nonsmokers and a determination by the EPA designating ETS as a "Group A" carcinogen, a designation indicating that there is sufficient evidence to conclude that ETS causes cancer in humans. Certain parties, including Reynolds Tobacco, filed suit to challenge the validity of the EPA report and the methodology and procedures used by the EPA to reach its conclusions. The United States District Court for the Middle District of North Carolina ruled in 1998 that the EPA's classification of ETS was invalid and vacated those portions of the report dealing with lung cancer. The EPA submitted an appeal and oral argument was held before the United States Fourth Circuit Court of Appeals in June 1999. The court's decision is still pending.

In 1994, the United States Occupational Safety and Health Administration ("**OSHA**") announced proposed regulations to restrict smoking in the workplace, but to date no regulations have been adopted. In December 2001, OSHA announced the withdrawal of its proposed regulations, stating that most of the activity on workplace smoking restrictions was taking place on the state and local levels. OSHA further stated that the announcement did not preclude future agency action.

In August 1996, the federal Food and Drug Administration (the "**FDA**") adopted regulations on the advertising, promotion and sale of cigarettes and smokeless tobacco. The FDA regulations included severe restrictions on the distribution, marketing and advertising of cigarettes, and required the tobacco industry to comply with a wide range of labeling, reporting, record keeping, manufacturing and other requirements. The FDA's action was based on its determination that nicotine was a drug and that cigarettes and smokeless tobacco were medical devices which delivered nicotine to the body within the purview of the Food, Drug and Cosmetic Act. On March 21, 2000, the United States Supreme Court affirmed a 1998 decision of the Fourth Circuit Court of Appeals invalidating the FDA's regulations. The Supreme Court held that the Food, Drug and Cosmetic Act as a whole, along with subsequent tobacco-specific legislation enacted by Congress, made it clear that Congress had precluded the FDA from regulating tobacco products as customarily marketed. Although the FDA has withdrawn its regulations, there are currently several bills pending in Congress that would give the FDA authority to regulate tobacco products. The pending legislation could result in substantial regulation of the design, performance, manufacture and marketing of cigarettes.

The invalidated FDA regulations included severe restrictions on the distribution, marketing and advertising of cigarettes, and required the tobacco industry to comply with a wide range of labeling, reporting, record keeping, manufacturing and other requirements. One OPM has stated that the FDA's exercise of jurisdiction, had it not been reversed by judicial action, could have led to more expansive FDA-imposed restrictions on cigarette operations than those set forth in the original regulations, and could have materially adversely affected the business, volume, results or operations, cash flows and financial position of the tobacco manufacturers.

Since the Supreme Court decision on the FDA regulations, legislation has been introduced in Congress that would give the FDA authority to regulate the sale, distribution, marketing and promotion of tobacco products to children, require tobacco companies to disclose the ingredients contained in cigarettes, and update warning labels. Members of Congress have also introduced legislation (some of which has been the subject of hearings or floor debate) that would, among other things, subject cigarettes to additional regulatory oversight, establish and provide additional funding for anti-smoking programs, further restrict the advertising of cigarettes, and eliminate certain defenses against liability under state statutory or common law. In July 2002, Senator Edward M. Kennedy introduced legislation that would give the FDA authority to regulate the promotion and advertising of tobacco products. At least one tobacco company has stated that, while it continues to oppose FDA regulation over cigarettes as "drugs" or "medical" devices, it would support new legislation that would provide for reasonable regulation by the FDA of cigarettes as cigarettes.

Federal law prohibits smoking on all scheduled passenger flights of U.S. airlines and on all scheduled passenger flights of foreign air carriers into or out of the United States. In addition, the United States Interstate Commerce Commission has banned smoking on buses transporting passengers interstate.

On August 9, 2000, the United States Surgeon General issued a report, "Reducing Tobacco Use: A Report of the Surgeon General," which comprehensively assesses the value and efficacy of the major approaches (educational, clinical, regulatory, economic and comprehensive) that have been used. 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 of up to 25% of their annual MSA settlement proceeds, a figure which is 16% higher than the 9% allocated to the first year's MSA 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 minors' access contribute to lessening smoking prevalence. Lastly, according to the Surgeon General's report, excise tax increases will reduce cigarette consumption.

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. 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 growers 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 calls 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.

State and Local Regulation. In addition to federal regulation, most of the states and many local jurisdictions have enacted legislation and regulations restricting displays and advertising of tobacco products, establishing fire safety standards for cigarettes, raising the minimum age to possess or purchase tobacco products, requiring the disclosure of ingredients used in the manufacture of tobacco products, imposing restrictions on public smoking and restricting the sale of tobacco products directly to consumers or other unlicensed recipients or over the Internet. According to the DRI•WEFA Report, up to 30 states have recently increased or are considering increasing their excise taxes on cigarettes. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund anti-smoking programs, healthcare programs and/or cancer research. Several states require disclosure of ingredients used in the manufacture of cigarette products. The Commonwealth of Massachusetts, for example, has enacted legislation to require cigarette manufacturers to report the flavorings and other ingredients used in each brand of cigarettes sold in Commonwealth, and on a qualified, by-brand basis to provide "nicotine-yield ratings" for their products based on standards established by the Commonwealth. Cigarette manufacturers sued to have the statute declared unconstitutional, arguing that it could result in the public disclosure of valuable proprietary information. In September 2000, the district court granted the plaintiff's motion for summary judgment and permanently enjoined the defendants from requiring cigarette manufacturers to disclose brand specific information on ingredients in their products. In October 2001, the First Circuit reinstated the statute, declaring it a "valid exercise of the police power" of the state. The First Circuit subsequently withdrew its opinion and granted a rehearing *en banc* to again address the taking and due process arguments which had previously been discussed. Arguments took place in January 2002, and a decision is pending.

In June 2000, legislation was adopted in the State which requires cigarettes sold in the state to be "self-extinguishing" beginning in 2003. Similar legislation is being considered by other states and localities and at the federal level. Another statute, which was intended to become effective in the State in November 2000, prohibited the shipment or delivery of cigarettes to any person in the State who is not a licensed cigarette tax agent, wholesale or retail dealer or export warehouse proprietor. The statute would have banned mail order, Internet and telephone cigarette sales directly to consumers in the State. One OPM and one SPM filed suit in a federal district court in the State seeking to overturn the statute, alleging that it was an unconstitutional interference with commerce. In June 2001, a federal district court judge declared the statute unconstitutional and permanently enjoined enforcement of the statute.

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

Civil Litigation

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (ii) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class 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. These other related suits include 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; class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices; 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.

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

One OPM has reported that as of May 1, 2002, there were approximately 1,500 active individual smoking and health cases pending in the United States against it and other tobacco industry defendants. Approximately 1,250 of these are pending before a single West Virginia state court in a consolidated proceeding that is set to begin in September 2002. In addition, one OPM reports that as of March 31, 2002 there were approximately 2,825 additional individual cases (referred to herein as the *Broin II* cases) filed primarily in Florida by individual current and former flight attendants claiming personal injury as the result of exposure 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 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. 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. In only one case have all post-trial motions and appeals been exhausted, and a plaintiff in an individual case has been paid.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of individual cases. In the last four years, there have been at least ten reported jury verdicts, including a 1996 verdict that was reinstated on appeal, in individual smoking and health cases against the tobacco industry, including one or more PMs. In February 1999, a California jury in *Henley v. Philip Morris, et al.* awarded $1.5 million in compensatory damages and $50 million in punitive damages (subsequently reduced by the trial judge to $25 million in punitive damages). On November 7, 2001, the appellate court affirmed the verdict. Philip Morris has appealed that decision to the California Supreme Court, which accepted the appeal on a "grant and hold" basis (another appeal has to be decided prior to ruling on the *Henley* petition). In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris, et al.* awarded $821,500 in compensatory damages and $79.5 million in punitive damages (subsequently reduced by the trial judge to $32 million). The initial jury verdict was reinstated by an Oregon appellate court on June 5, 2002. Philip Morris has stated its intention to appeal the case to the Oregon Supreme Court. In April 1999, a Maryland jury in *Connor v. Lorillard, et al.* awarded $225,000 in compensatory damages and $2 million in punitive 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., et al.* 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. The defendants have appealed the verdict. 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. The plaintiff has appealed the new trial ruling. 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 of 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 for a tobacco-related illness. On June 29, 2001, the United States Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact. On June 6, 2001, in *Boeken v. Philip Morris Incorporated, et al.*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award has been reduced to $100 million post-trial. Philip Morris has filed a notice of appeal. On December 12, 2001, a Florida state court jury awarded the plaintiff $165,000 in compensatory damages in *Kenyon v. R.J. Reynolds Tobacco Co.* on the basis that Reynolds Tobacco had marketed a defectively designed product. The jury declined to award punitive damages. Reynolds Tobacco has moved to set aside the verdict. On February 22, 2002, a federal jury in Kansas City awarded $196,416 in compensatory damages to a former smoker in *Burton v. R.J. Reynolds Tobacco Co., et al.* The jury also determined that punitive damages were appropriate and, after a separate hearing was held to address that issue, the trial judge awarded the plaintiff $15 million in punitive damages. Both Reynolds Tobacco and B&W have stated they will appeal the verdict. On March 22, 2002, a Portland, Oregon jury awarded $168,000 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 award to $100 million. Philip Morris has indicated that it will appeal the verdict. In addition, the California Supreme Court in *Naegele v. Raybestos-Manhattan, Inc.* and *Myers v. Philip Morris, Inc.* will assess the retroactive effect of 1998 amendments to a California statute which repealed the classification of tobacco as an "inherently unsafe" consumer product that is immune from liability. Whereas *Naegele* will consider whether the 1998 amendments apply to claims that accrued prior to January 1, 1998, *Myers* will address whether the 1998 amendments apply to claims that accrued after January 1, 1998, but which are based on conduct occurring prior to January 1, 1998. Oral arguments have been heard, and a decision is pending.

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. 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 29 smoking and health class actions.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of class action cases. Published federal cases which have considered the question to date have denied class certification, including two federal court of appeals decisions. In May 1996, the Fifth Circuit Court of Appeals overturned the certification of a nationwide class of smokers in *Castano v. American Tobacco Company Inc.* In May 1999, the United States Supreme Court declined to review the Third

Circuit's decertification of the class in *Barnes v. American Tobacco Company, Inc.* (formerly called *Arch v. American Tobacco Company*). In March 2001, in *Guillory v. American Tobacco Co., Inc.*, the United States District Court for the Northern District of Illinois refused to certify a class defined as "all Illinois residents who smoke or smoked cigarettes manufactured by the defendants, who started smoking while a minor, who purchase or purchased cigarettes in Illinois and who desire to participate in a program designed to assist them in the cessation of smoking and/or monitor their medical condition to promote early detection of disease caused by, contributed to, or exacerbated by cigarette smoking." In May 2001, in *Brown v. Philip Morris, Inc.*, the United States Court of Appeals for the Third Circuit affirmed the trial court's dismissal of a proposed class action alleging the violation of civil rights by the targeting of "African-American smokers." On June 29, 2001, the United States District Court for the District of Nevada denied plaintiffs' motions for class certification in three cases involving casino workers exposed to environmental tobacco smoke and one case involving smokers with injuries allegedly caused by smoking. In October 2001 in *Estate of Mahoney v. R.J. Reynolds Tobacco Co., Inc.*, the United States District Court for the Southern District of Iowa denied plaintiffs' motions for class certification of a class defined as individuals who had smoked the defendants' cigarettes for more than 20 years and who now suffered or had died from lung cancer.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in United States District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases include 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 seeks 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. One OPM has reported that Judge Weinstein has indicated an intent to certify a class to hear the punitive damage claims. Two of the ten cases, *Falise v. American Tobacco Co.*, and *H.K. Porter Company, Inc. v. The American Tobacco Company, et al.* were dismissed in June 2001 and July 2001, respectively.

A number of state courts have also 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, et al.* 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 residents of the State, including their heirs, representatives, and estates, who contracted lung and/or throat cancer as a result of smoking cigarettes. Plaintiffs filed a motion for leave to appeal the order denying certification to the New York Court of Appeals, the highest court in the State. The New York Court of Appeals dismissed the plaintiff's appeal in February 2001.

In November 2000, a New York state appellate court reversed a trial court ruling that would have permitted eight separate individual personal injury suits against tobacco companies to be brought in a joint trial. In *Glussi v. Fortune Brands, Inc.*, 714 N.Y.S.2d 516 (N.Y. App. 2000) (also known as the *Apostolou* case), the State's appellate division for the Second Department held that combining the various plaintiffs' claims into a single suit would be too unwieldy and awkward to permit the claims to be fairly heard. Although not technically a class action, the appellate holding confirms the general reasoning behind other decertifications of anti-tobacco class actions. In January 2001, the jury in the *Apostolou* case ruled in favor of the defendants and no punitive damages were awarded.

To date, plaintiffs have successfully maintained class certification in state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, West Virginia and North Carolina.

In *Engle v. R.J. Reynolds Tobacco Co., et al.*, 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 Phase I 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 Phase IIA, in April 2000, the same jury that heard Phase I awarded a total of $12.7 million in compensatory damages to the three named representative plaintiffs, finding that the defendant tobacco companies bore major responsibility for the plaintiffs' injuries. One OPM has requested that the court dismiss the award to one of the plaintiffs because of the jury's findings on a statute of limitations question. In July 2000, in Phase IIB, the same jury also assessed punitive damages of approximately $145 billion with respect to the entire class of possible plaintiffs. The punitive damages awarded against the OPM defendants are: Philip Morris, $73.96 billion; Reynolds Tobacco, $36.28 billion; B&W, $17.59 billion; Lorillard, $16.25 billion; and Liggett, $790 million. Phase III will determine compensatory damages for the remaining class members.

On July 24, 2000, the defendants filed a motion with the trial court to, among other things, set aside the verdict, direct judgment in favor of the defendants or decertify the class, and/or order a new trial. On July 14, 2000, the Southeastern Iron Workers Union filed a motion to intervene in *Engle* seeking to protect its members' subrogation rights under the federal Employment Retirement Income and Security Act. Based on the federal question raised in that motion, defendants removed the case to federal district court in Miami on July 24, 2000. By order dated November 3, 2000, however the United States District Court for the Southern District of Florida remanded *Engle v. Reynolds Tobacco, et al.* to the Eleventh Judicial Circuit of Dade County, Florida (the "**State Trial Court**"). On November 6, 2000, the State Trial Court issued its final judgment and order in which it (a) denied substantially all of the tobacco company defendants' pending and post-trial motions, including the motion for reduction of the $145 billion punitive damages award or, in the alternative, a new trial, and (b) entered the punitive damage award as a final judgment. On November 7, 2000, the defendants in *Engle* filed an appeal with respect to the entry of judgment, class certification and other reversible errors that they allege occurred during the trial. 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. 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: the amount of punitive damages, plus twice the statutory rate of interest; or 10% of a defendant's net worth, but in no case more than $100 million. Georgia, Kentucky, Louisiana, Nevada, North Carolina, Oklahoma, South Carolina, Virginia and West Virginia have enacted similar legislation. The Mississippi Supreme Court has also placed limitations on appeal bonds by court rule.

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, 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. Pursuant to the Stipulation, Philip Morris 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 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 Lukacs the right to proceed before he died, but stated that any award in favor of the plaintiff will 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. The tobacco companies are appealing this verdict. One OPM reports that there are at least six similar suits pending in Florida courts where plaintiffs allege they are members of the *Engle* class and trial should begin immediately. That OPM argues that such trials should be stayed during the pendency of the *Engle* appeal.

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 also retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. One OPM reports that as of March 31, 2002, approximately 2,835 of these individual cases (known as *Broin II* cases) had been brought. In October 2000, the court 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' attempt to appeal was dismissed as premature. On January 16, 2002, the defendants filed a suit to invoke the discretionary jurisdiction of the Florida Supreme Court.

On April 5, 2001, a jury returned a verdict for the defendants in the case of *Fontana v. Philip Morris Incorporated, et al*., the first of the *Broin II* cases to go to trial. The plaintiff has filed motions for a mistrial, a new trial and a judgment notwithstanding the verdict. On October 1, 2001, the trial court denied the plaintiffs' post-trial motions. The plaintiffs filed an appeal, and the defendants filed a cross-appeal. It has been reported that on June 18, 2002, a Florida jury found against the tobacco industry defendants and awarded the plaintiff $5.5 million in the case of *French v. Phillip Morris*, finding that the flight attendant's sinus disease was caused by ETS. The co-defendants intend to ask the trial court to set aside the verdict and will appeal if necessary. As of March 31, 2002, one OPM reports that approximately 12 additional *Broin II* cases are scheduled for trial during 2002.

The court upheld class certification in *Scott v. American Tobacco Company, Inc.* and *In re Tobacco Litigation.* In *Scott*, a Louisiana medical monitoring and/or smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and/or to 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 bring individual smoking and health lawsuits, if they desire. The trial court's certification of the class has survived initial appeal. Trial began in June 2001. Defendants appealed the jury selection process to the Louisiana Fourth Circuit Court of Appeal on July 18, 2001. On September 4, 2001, the Court of Appeal dismissed two jurors because of bias, but declined to dismiss jurors with immediate family members who were members of the class. On September 5, 2001, defendants sought review by the Louisiana State Supreme Court. On September 25, 2001, the Louisiana State Supreme Court dismissed seven additional jurors because they have immediate family members who are members of the class and the seven jurors expressed a desire that those family members receive medical monitoring or smoking cessation assistance. On October 9, 2001, the defendants asked the Louisiana Supreme Court to declare a mistrial because of the irregularities in the jury selection process. This petition was denied on October 15, 2001. Jury selection resumed again on October 22, 2001, and a full complement of 12 jurors and 10 alternates was selected. In March 2002 the Louisiana Supreme Court granted the defendants application for a supervisory writ and struck four jurors from the panel due to possible bias. Jury selection has been reopened.

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 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 defendant's 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. Plaintiffs' motion for retrial was denied in January 2002.

One OPM reports that in West Virginia, all smoking and health cases alleging personal injury have been consolidated for trial by the state's Mass Litigation Panel ("**MLP**"). The transferred cases include individual cases as well as putative class actions. All actions filed in or transferred to the court before September 8, 2000 (numbering approximately 1,250) are to be included in a single trial. The trial court's order provides for the trial to be conducted in two phases. Phase One of that trial will address general liability issues common to all defendants as well as entitlement to punitive damages and a punitive damages multiplier. Phase two of the trial will address the individual claims of plaintiffs. Trial is scheduled to begin in September 2002.

In *Daniels v. Philip Morris, et al.*, 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. Defendants appealed the trial court's certification ruling but their writ was denied. Trial is scheduled for July 2002. In addition, in *Daniels, et al. v. Philip Morris Companies, Inc., et al.*, a separate class action was certified that contends Philip Morris and other cigarette manufacturers violated the state's unfair business practice laws. The court did not allow the plaintiffs' claims for punitive damages under the state's consumer protection laws. The plaintiffs are seeking over $1.0 billion in restitution for the state's smokers. Philip Morris has indicated that it will appeal the class certification.

During April 2001, a California state court issued an oral ruling in the case of *Brown v. The American Tobacco Company, Inc., et al.*, 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 defendant violated California Business and Professional Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiff's claims under the California Legal Remedies Act. Defendant's writ with the court of appeals challenging the trial court's class certification ruling was denied on January 16, 2002. The trial has been rescheduled for October 2002.

In *Miles v. Philip Morris Cos., Inc.*, an 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. The plaintiffs in that case allege consumer fraud claims and seek economic damages in the form of a refund of purchase costs of the cigarettes. The plaintiffs do not seek damages for health related personal injury claims. Trial is scheduled for January 2003. Illinois courts certified similar classes in *Turner v. R.J Reynolds Tobacco Co.* and *Howard v. Brown & Williamson.* In addition, in October 2001, a Massachusetts state court judge certified a similar class in *Aspinall, et al. v. Philip Morris Companies and Philip Morris, Inc.*, claiming analogous violations of Massachusetts' consumer protection statutes. In February 2002 a Florida state court certified a class action, *Hines v. Philip Morris* alleging that Philip Morris engaged in deceptive practices in marketing certain cigarettes as low tar and low nicotine.

On May 23, 2001, a lawsuit was filed in the United States District Court for the District of Columbia styled *Sims, et al. v. Philip Morris Incorporated, et al.*, which seeks class action status for millions of youths who began smoking cigarettes before their 18th birthday. Plaintiffs seek to recover moneys that underage smokers spent on cigarettes before their 18th birthday, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleges that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising.

On November 14, 2001, in *Turner v. R.J. Reynolds Tobacco Co.,* an Illinois 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 . . . ." Trial is scheduled for March 17, 2003.

Most recently, it has been reported that on April 4, 2002, a federal district court in North Carolina granted class certification to a group of farmers from Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee, accusing cigarette manufacturers of conspiring to set prices offered for tobacco. In July 2002 the Fourth Circuit Court of Appeals affirmed the class certification.

Healthcare Cost Recovery Lawsuits. Plaintiffs in the healthcare cost recovery cases include the United States and foreign governmental entities or others, such as labor unions, private companies, HMOs, hospitals, other third-party payors, native American tribes or private citizens suing on behalf of taxpayers who seek reimbursement of healthcare costs allegedly incurred as a result of smoking, as well as other alleged damages. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. One OPM has reported that as of May 1, 2002, there were at least 44 active healthcare cost recovery cases pending in courts in the United States against manufacturers of tobacco products, of which approximately ten were filed by union trust funds. On May 22, 2001, several of these union trust fund lawsuits were dismissed by the United States Court of Appeals for the District of Columbia. The Court held that plaintiffs' claims were too remote because the alleged injuries were to union members, not union health care trust funds.

Eight federal courts of appeals have issued rulings in healthcare cost recovery actions favorable to the tobacco industry. The United States Courts of Appeals for the Second, Third, Fifth, Seventh, Eighth, Ninth, Eleventh and D.C. Circuits, relying primarily on grounds that the plaintiffs' claims were too remote, have affirmed dismissals of, or reversed trial courts that had refused to dismiss, such actions. In January 2000, the United States Supreme Court denied plaintiffs' petitions for writs of certiorari in the cases decided by the Court of Appeals for the Second, Third and Ninth Circuits, effectively refusing to consider plaintiffs' appeals. Although there have been decisions to the contrary, a number of lower courts that have decided motions in these cases have dismissed all or substantially all of the claims against the tobacco industry.

Several foreign countries or subdivisions thereof have filed actions in Florida state courts to recover the costs of treating persons with diseases associated with tobacco use. The tobacco companies removed the cases to Federal District Court, and the cases were transferred to the United States District Court for the District of Columbia. The District Court remanded the cases brought by Venezuela, Ecuador, and the Brazilian states of Espirito Santo and Goias to Florida State Court. In April 2002, in *Republic of Venezuela v. Philip Morris Incorporated*, the United States Circuit Court for the D.C. Circuit refused to review the remand decision for lack of appellate jurisdiction. The Circuit Court also refused to prohibit the District Court from remanding similar cases brought by Russia and the Brazilian State of Mato Grosso Do Sol. The Florida Court has dismissed the Venezuela and Espirito Santo cases.

On June 4, 2001, in a U.S. District Court in Brooklyn, New York, a federal jury found that Philip Morris, R.J. Reynolds and B&W engaged in deceptive business practices in a case brought by Empire Blue Cross Blue Shield. The jury ruled that the companies must pay up to $17.8 million in a case in which Empire sought to be reimbursed for billions of dollars it allegedly spent on smoking-related costs. The jury rejected the plaintiff's RICO claim on October 4, 2001, the Court denied the defendants' post-trial motions and thereafter the defendants appealed the final judgment to the United States Court of Appeals for the Second Circuit. In February 2002, the court granted the plaintiffs' counsel's request for attorney fees in the approximate amount of $37.8 million. The defendants have appealed.

In September 1999, the United States Department of Justice filed a lawsuit against the OPMs, certain related parent companies, and two tobacco industry research and lobbying organizations. Among other things, the federal lawsuit sought to recoup Medicare and other medical expenses of the federal government pursuant to the Medical Care Recovery Act and the Medicare Secondary Payer Act relating to smoking-related illnesses, and alleges violations of the federal RICO statute. The lawsuit seeks unspecified damages, disgorgement of profits by the OPMs under the RICO statute and certain other relief, including an injunction requiring the defendants to make certain public statements in the marketing and promotion of their products regarding the health risks of tobacco and to fund anti-smoking education campaigns and smoking cessation programs. In December 1999, defendants filed a motion to dismiss this lawsuit on several grounds, including that the statutes invoked by the government do not provide a basis for the relief sought. On September 28, 2000 the district court ruled that the government could not use the Medical Care Recovery Act or the Medicare Secondary Payer Act to recover Medicaid expenses related to ill smokers and granted the defendants' motions to dismiss these claims. The district court also ruled that the government could proceed with its other claims under the RICO statute. The federal government has requested that the court reinstate the dismissed claims. The court denied that motion on January 31, 2001. In February 2001, the government filed an amended complaint attempting to replead the Medicare Secondary Payer Act claim. In July 2001, the court dismissed the amended complaint. In June 2001, the Department of Justice began to work on a possible settlement of the federal lawsuit. The Department of Justice met with representatives of the tobacco industry on July 18, 2001. No settlement was reached. In December 2001, the Department of Justice filed a pre-trial document setting forth some of the remedies it may seek in the lawsuit. In that document the Department of Justice indicated that it may seek severe limitations on the marketing and promotion of cigarettes. These limitations include requiring 50% of cigarette-pack surfaces to carry "graphic" health warnings and messages from the U.S. Surgeon General; requiring packs to carry health-leaflet inserts; eliminating slotting fees paid to retailers for favorable placement of tobacco products in store; publicly disclosing manufacturing methods, marketing research, ingredients, additives and toxic chemicals; forbidding "light," "low-tar" or "mild" labels; banning vending machine sales; ending trade promotions and give-aways; and restricting all cigarette advertising to black-and-white-only formats, with 50% of the space dedicated to "graphic" health warnings. Trial is scheduled for July 2003 on the RICO claims. Philip Morris has stated that it believes it has a number of valid defenses to the lawsuit and will continue to vigorously defend it.

In *A.O. Fox Memorial Hospital, et al. v. American Tobacco Company, Inc., et al.*, a group of 175 New York State hospitals filed suit in March 2000 in New York Supreme Court, Nassau County, against various defendants, including PMs, seeking to recover unreimbursed and under-reimbursed costs in connection with past, present and future healthcare provided to patients suffering from tobacco-related illnesses. The lawsuit seeks a minimum of $3.6 billion in damages. On January 17, 2002, the plaintiffs moved to appeal the dismissal of the complaint. In October 2001, in *Allegheny General Hospital, et al. v. Philip Morris, Inc., et al.*, the Third Circuit affirmed the dismissal of a complaint against the tobacco industry brought by a group of Pennsylvania hospitals seeking to recover unreimbursed healthcare costs. The Ninth Circuit has affirmed the dismissal of similar claims brought by a group of Washington hospitals in *Association of Wash. Pub. Hosp. Dists., et al. v. Philip Morris, Inc., et al.* In October 2001, the U.S. Supreme Court denied the motion for a writ of certiorari.

A number of foreign countries have filed suit in state and federal courts in the United States against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. One OPM has reported that of the 33 cases currently pending as of March 31, 2002, 6 are pending in state court and 27 are pending in federal court. Eleven of those cases have been transferred to the District of Columbia. Other foreign governments and entities have stated that they are considering filing such actions in the United States. In October 2001, the United States Supreme Court denied certiorari, letting stand an appellate decision dismissing claims by Guatemala, Nicaragua and Ukraine seeking reimbursement of money spent treating tobacco-related illness.

In recent years there has been a substantial increase in the number of tobacco-related cases. The tobacco industry has entered into settlements of certain lawsuits based on smoking-related claims. These include its settlement of *Broin I*, the lawsuits filed by the Previously Settled States, lawsuits filed by the Settling States which were settled by the MSA and others.

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 examples of tobacco-related related litigation:

- Asbestos contribution cases whereby former asbestos manufacturers, their personal injury settlement trusts and insurers seek 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. As of May 1, 2002, an estimated 12 suits were pending on behalf of former asbestos manufacturers, asbestos manufacturers' personal injury settlement trusts and an insurance company against tobacco manufacturers. On May 24, 2001, a Mississippi state court rejected claims by asbestos manufacturer Owens Corning that the tobacco companies should reimburse it for payment of asbestos related injury claims that were allegedly caused by cigarette smoking. The Court held that Owens Corning's alleged injures were too remote to recover damages for the asbestos injury claims. Owens Corning has appealed and has filed a similar suit in California. In addition, in *Falise, et al. v. American Tobacco Company, Inc.*, the United States District Court for the Eastern District of New York dismissed similar claims on consent after mistrial.
- California "Proposition 65" cases, whereby two California cities seek damages for failure to warn that exposure to ETS may cause illness under a law requiring that California residents be informed if they are exposed to substances that are alleged to cause cancer or birth defects. Both cases settled. The two settlement agreements collectively resolve all claims that were, or could have been, brought in these two actions. In November 2000, the court granted defendants' motion seeking approval of both settlements and entry of a final judgment in both cases.
- According to one OPM, as of February 28, 2002 there were approximately 40 lawsuits filed by tobacco wholesalers, or indirect purchasers, against domestic cigarette manufacturers alleging that cigarette manufacturers combined and conspired to set the price of cigarettes, in violation of antitrust statutes and various state unfair business practices statutes. The plaintiffs are asking the court to certify the lawsuits as class actions, and to allow the respective plaintiffs to pursue the lawsuits as representatives of other persons in the United States, and throughout the world, that purchased cigarettes directly from one or more of the defendants. The federal cases have been consolidated and sent by the Judicial Panel on Multidistrict Litigation for pre-trial in the United States District Court for the Northern District of Georgia. On November 30, 2000, that court dismissed plaintiffs' claims of fraudulent concealment, claims concerning conduct outside the United States, and allegations relating to non-price conduct. The court again dismissed the fraudulent concealment claims on June 19, 2001, after plaintiffs attempted to replead them. On January 23, 2001, the federal court certified a class of direct-purchaser plaintiffs. On July 22, 2002, the judge dismissed the case. Plaintiffs' attorneys said that an appeal is planned. At the state level, the Arizona case was dismissed on February 28, 2001, and plaintiffs filed a notice of appeal on May 30, 2001. Discovery in all remaining state cases, except Kansas, is being coordinated with the federal cases. Discovery in the federal cases ended July 31, 2001. A Minnesota court denied class certification on November 21, 2001. A Kansas court granted class certification on November 15, 2001. In April 2002, in *Deloach v. Philip Morris*, a federal court in North Carolina certified a class of tobacco producers who allege a conspiracy on the part of members of the tobacco industry to fix prices in violation of antitrust laws. In July 2002 the Fourth Circuit Court of Appeals affirmed the class certification.
- Separate federal district court lawsuits commenced by 22 Colombian states (May 2000) and Ecuador (June 2000) alleging that various OPMs engaged in sophisticated conspiracies to smuggle cigarettes into those respective countries in an effort to evade duties and/or taxes. Plaintiffs seek unspecified amounts in actual damages, treble damages, punitive damages and equitable relief in each of the three suits. A similar lawsuit brought by several Canadian provinces was dismissed in July 2000, and the United States Court of Appeals for the Second Circuit upheld that dismissal in October 2001. In February 2002, a federal court in Miami dismissed similar claims brought by Ecuador, Belize and Honduras.
- On November 3, 2000, the European Community ("**EC**") commenced an action in the United States District Court for the Eastern District of New York against Reynolds Tobacco, Philip Morris, and related companies. The EC complaint alleges several claims, including RICO, common

law fraud, public nuisance, and unjust enrichment. The EC also alleges that Philip Morris, Reynolds Tobacco, and related companies engaged in a conspiracy to smuggle cigarettes into EC member states, thereby depriving the EC and its member states of custom duties and value added taxes. The complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. On July 18, 2001, the court dismissed the case, stating that the EC had been unable to prove "that it has suffered any injury as a result of the defendants' illegal acts." On August 6, 2001, the EC and ten member states filed a complaint against Reynolds Tobacco, Philip Morris, and related companies. Other than the addition of the member states as parties, the EC complaint is essentially a resubmission of the first complaint filed on November 3, 2000. The EC complaint alleges that Philip Morris, Reynolds Tobacco, and related companies engaged in a conspiracy to smuggle cigarettes into EC member states in an effort to evade taxes, thereby depriving the EC and its member states of custom duties and value added taxes. The complaint seeks unspecified damages including compensatory damages, injunctive relief, and treble damages under RICO. In February 2002, the district court dismissed the lawsuit with prejudice insofar as it sought redress for tobacco smuggling. The district court dismissed the money laundering claims without prejudice. The EC has appealed.

- There are six actions pending against Reynolds Tobacco alleging various violations of the MSA. Four states, Arizona, California, New York and Washington allege that the posting of signage advertising Reynolds Tobacco's brand name sponsorships violates a provision of the MSA governing the times during which such signs may be posted. In November 2001, trial courts in Arizona and California ruled in favor of the state. On February 1, 2002, however, a New York state trial court upheld Reynolds Tobacco's position. Appeals of all of these decisions are pending. Trial in the Washington matter is scheduled for August 5, 2002. The fifth action by the State of Ohio alleges that Reynolds Tobacco's purchase of advertising space on matchbooks distributed by an independent third party violates a provision of the MSA governing brand name merchandise. The sixth action by the State of California has alleged that the publications in which Reynolds Tobacco places advertising evidences the direct or indirect targeting of youth, which is prohibited by the MSA. On June 6, 2002, the trial judge in this case fined Reynolds Tobacco $20 million for violating the MSA, and ordered it to take reasonable measures to reduce youth exposure to cigarettes.
- On June 28, 2001, in *Lorillard Tobacco Company v. Reilly*, the U.S. Supreme Court ruled that the State of Massachusetts could not impose its own advertising restrictions on tobacco beyond the federal law that bans cigarette advertising and requires warning labels on packages. Based on the First Amendment, the Court found that the attorney general failed to show that Massachusetts' outdoor advertising regulations for smokeless tobacco and cigars were not more extensive than necessary to advance the state's interest in preventing underage tobacco use.
- Lawsuits 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.
- Civil rights claims alleging improper marketing of cigarettes to African-American smokers. In one such case, *Jesse Brown v. Philip Morris*, the Third Circuit affirmed the dismissal of the lawsuit.
- In January 2001, in *In Re: Cigarette Antitrust Litigation (Federal Multidistrict Litigation Panel, U.S. Dist. Ct., Northern District of Georgia)* the court hearing seven consolidated federal class action cases alleging that the defendants conspired to fix cigarette prices in violation of antitrust laws, certified a class of plaintiffs who made direct purchase between February 1996 and February 2000. In April, 2002, in *DeLoach v. Philip Morris*, a federal court in North Carolina certified a class of tobacco producers who allege a conspiracy on the part of members of the tobacco industry to fix prices in violation of antitrust laws.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon TSASC's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs, other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2002-1 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.

DRI•WEFA REPORT

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

General

DRI•WEFA, Inc., formerly known as WEFA, Inc., has prepared a report dated August 1, 2002 (the "**DRI•WEFA Report**") for TSASC on the consumption of cigarettes in the United States from 2001 through 2042 entitled, "*A Forecast of U.S. Cigarette Consumption (2001-2042) for TSASC, Inc.*" DRI •WEFA is an internationally recognized econometric and consulting firm of over 200 economists in 16 offices worldwide. DRI•WEFA is a privately held subsidiary of Global Insight, Inc., a publicly traded company which is a provider of financial, economic and market research information.

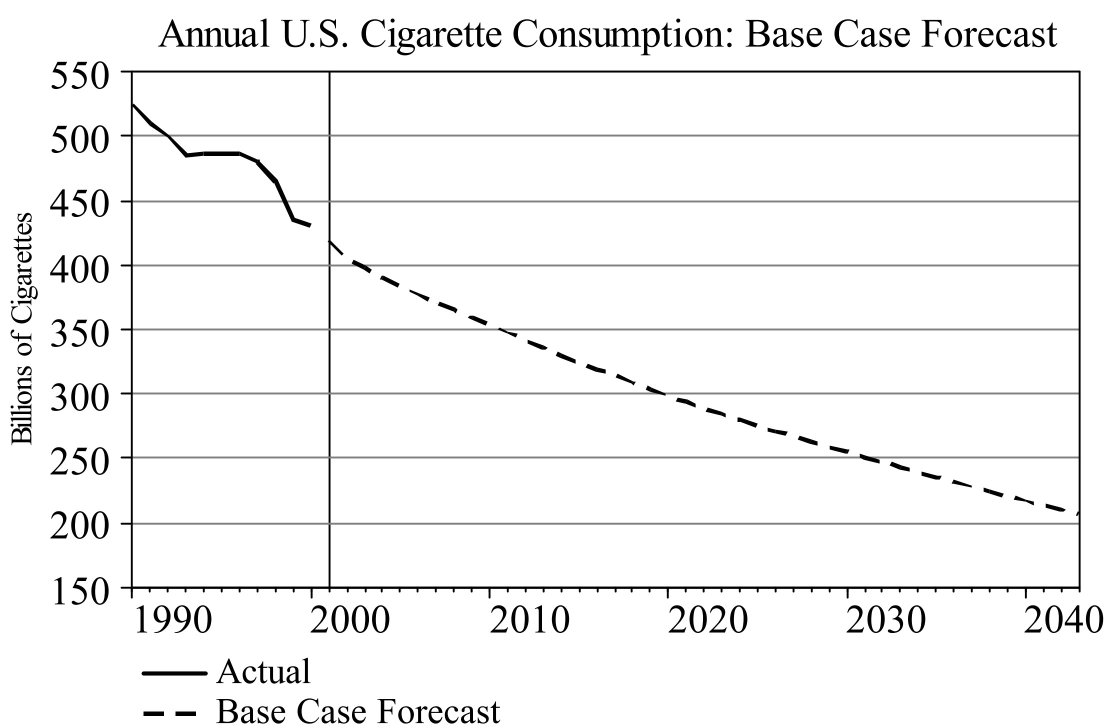
DRI•WEFA has developed a cigarette consumption model based on historical United States data between 1965 and 2000. DRI•WEFA constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising 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), DRI•WEFA employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The regression analysis for the period 1965 to 1999 showed: (i) long run price elasticity of demand of -0.31; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.32% per year holding other recognized significant factors constant.

DRI•WEFA's model, coupled with its long term forecast of the United States population and real per capita personal disposable income, was then used to project total United States cigarette consumption from 2001 through 2042 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total United States cigarette consumption in 2042 will be 210 billion cigarettes (approximately 10.5 billion packs), a 51% decline from 2000 levels. After 2003, the rate of decline in total cigarette consumption is projected to moderate and average less than 2% per year. From 2000 through 2042, the average annual rate of decline is projected to be 1.69%. On a per capita basis, consumption is forecast to fall during the same period at an average annual rate of 2.48%. Total consumption of cigarettes in the United States is forecast to fall from an estimated 430 billion in 2000 to under 400 billion by 2003, to under 300 billion by 2020, and to reach 210 billion in 2042. The DRI•WEFA Report states that DRI•WEFA believes that the assumptions on which the Base Case Forecast is based are reasonable. The results of the Base Case Forecast are shown in the following table:

DRI•WEFA Base Case Forecast of Cigarette Consumption

Calendar Year	Cigarettes (Billions)	Calendar Year	Cigarettes (Billions)
2001	419.00	2022	288.83
2002	402.96	2023	284.10
2003	391.85	2024	279.72
2004	385.27	2025	275.39
2005	380.68	2026	271.14
2006	375.67	2027	267.00
2007	370.50	2028	262.94
2008	365.00	2029	258.94
2009	358.90	2030	255.01
2010	353.27	2031	251.03
2011	347.65	2032	247.16
2012	341.81	2033	243.36
2013	335.90	2034	239.56
2014	329.95	2035	235.39
2015	324.71	2036	231.65
2016	319.48	2037	227.99
2017	314.11	2038	224.45
2018	308.83	2039	220.75
2019	303.49	2040	217.15
2020	298.55	2041	213.66
2021	293.59	2042	210.09

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



The DRI•WEFA Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2042 total United States consumption could be as low as 192 billion or as high as 225 billion cigarettes.

Comparison with Prior Forecasts

On October 25, 1999, DRI•WEFA presented a similar study, "*A Forecast of U.S. Cigarette Consumption (1999-2042)*" (the "**1999 Report**"), with long-run conclusions quite similar to those in the DRI•WEFA Report. The DRI•WEFA Report cigarette consumption forecast as of 2042 is 7% greater than was forecast in the original study—210 billion versus 196 billion cigarettes.

DRI•WEFA has incorporated new data into the current DRI•WEFA Report. DRI•WEFA increased its retail price assumption for 2000 from $3.03 to $3.39, and correspondingly decreased its consumption forecast for the year to 411 billion. However, aggressive discounting at the retail level has resulted in a lower average price for the year of $3.20 per pack. Similarly, in 2001, retail prices averaged $3.44 per pack, 4.4% lower than the $3.60 the forecast had assumed. DRI•WEFA states that increased consumption due to lower than anticipated prices explains most of the revision to the 2000 and 2001 consumption forecasts. For 2001, the DRI•WEFA Report projects a consumption level of 419 billion, or 11 billion more cigarettes than was forecast in DRI•WEFA's 2001 forecast. The DRI•WEFA Report also differs somewhat from DRI•WEFA's forecast presented earlier in 2002. Because a greater number of states have raised taxes on cigarettes in response to state budget difficulties than was previously anticipated, the DRI•WEFA Report projects that cigarette consumption will be lower in the near term than was projected in the earlier forceast. The DRI•WEFA Report projects that cigarette consumption will fall to 403 billion in 2002, 2 billion fewer than the previous 2002 forecast, and to 392 billion in 2003, 5.6 billion fewer than the previous 2002 forecast.

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. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998 and 430 billion cigarettes in 2000.

While the historical trend in cigarette consumption prior to 1981 was increasing, between 1931 and 1932 there was a decline of 9.82% in consumption during the Great Depression. Notwithstanding this steep decline, consumption rapidly increased after 1932, exceeding previous levels by 1934. Following the release of the United States Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.20% between 1965 and 1981. Between 1981 and 1990, however, cigarette consumption declined at an average annual rate of 2.18%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.51%; but for 1998 the decline increased to 3.13% and then the decline for 1999 accelerated to 6.45%. These sharp recent declines are correlated with large price increases in 1998 and 1999.

Following the 1964 Surgeon General's Report, adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) began to decline. Population growth offset this decline until 1981. The adult population (people 18 years and older) 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 recent declines are correlated with large price increases in 1998 and 1999. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the six years ended December 31, 2000. The data in this table vary from statistics on cigarette shipments in the United States. While the DRI•WEFA Report is based on consumption, payments under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

Historical Cigarette Consumption for Past Five Years

Calendar Year	Cigarettes (Billions)	Percentage Change
2000	430	–1.15%
1999	435	–6.45%
1998	465	–3.13%
1997	480	–1.44%
1996	487	0.00%
1995	487	0.21%

Survey of the Economic Literature on Smoking

A number of 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. According to a Centers for Disease Control and Prevention ("**CDC**") survey released in October 2001, approximately 46.5 million American adults were current smokers in 1999, representing approximately 23.5% of the population age 18 and older. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who have 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, the incidence rate has declined relatively slowly through the next decade. The National Center for Health Statistics presents a preliminary estimate of adult incidence for 2000 of 23.3%.

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 2001, however, the incidence rate had fallen to 28.5%, just 3.6% above the 1991 level. The Youth Tobacco Surveillance (YTS) report, issued in November 2001 by the CDC is a supplement to the Youth Risk Behavior Survey. The YTS covers calendar year 2000 and provides more comprehensive data on tobacco use among both middle and high school students as well as data on secondhand smoke exposure, ability to obtain tobacco products and knowledge of, and attitudes about, tobacco and tobacco advertising (both pro-and anti-tobacco). Some of the results pertaining to cigarette use can be found in the table below.

Youth Risk Behavior Survey

	Middle School Students Grades 6-8	High School Students Grades 9-12
Ever Used Tobacco	36.3%	64.0%
Current Cigarette Users	11.0%	28.0%
Ever Smoked Cigarettes Daily	5.5%	20.6%
First Smoked Before Age 11	8.4%	6.7%

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 among eighth, tenth and twelfth graders was lower in June 2001 than in June 2000, the fourth consecutive annual decline. However, incidence levels for 10th and 12th graders continue to remain higher than in June 1991. Smoking incidence for 8th graders has fallen below its level in 1991. The figures from June 2001 represent a decrease from the 1991 figures of 14.7% for eighth graders, but represent an increase from the 1991 figures of 2.4% for tenth graders and 4.24% for twelfth graders. The 2001 figures alone, however, represent a decrease from the 2000 figures of 16.4% for eighth graders, 10.9% for tenth graders and 6.1% for twelfth graders.

The 2000 Household Survey on Drug Abuse conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services estimated that approximately 55.7 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 the 25.8% 1999 level. The same survey found that an estimated 13.4% of youths age 12 to 17 were current cigarette smokers in 2000, which is a decrease from the 14.9% 1999 level.

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

Two studies recently 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. 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. A study by Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors, and that the price elasticity of cessation for males averaged 1.12 and for females averaged 1.19. According to the DRI•WEFA Report, 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.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. According to the DRI•WEFA Report, the results of the study suggest that (a) the average estimated price elasticity of smoking participation is -0.26, and (b) 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%.

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation. The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least 1-5 cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are -0.27 for any smoking, -0.81 for smoking at least 1-5 cigarettes, and -0.96 for smoking at least one-half pack of cigarettes. These results 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.

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. 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."

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. 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 the decline in the quantity of cigarettes consumed by that smoker.

Factors Affecting Cigarette Consumption

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

General Population Growth. DRI•WEFA forecasts that the United States population will increase from approximately 272 million in 1999 to approximately 385 million in 2042. This forecast is consistent with the Bureau of the Census forecast based on the 1990 Census. On December 28, 2000 the Bureau reported results from the 2000 Census that estimate the U.S. population on April 1, 2000 to be 281 million. DRI•WEFA has not yet incorporated this data into its analysis because it has yet to be reconciled by the Bureau to its 1990 estimate. That 1990 Census estimate likely suffered from a significant undercount of population. As the USDA, in its estimate of per capita consumption, also uses the estimates based on the 1990 Census, the DRI•WEFA forecast is consistent with its history. When the correct population data from 1990 to 2000 is released it is expected to show that per capita consumption of cigarettes was slightly lower than originally thought, but that its growth trend is the same. DRI•WEFA does not expect the revised population and per capita consumption levels to affect its forecast of total cigarette consumption.

Price Elasticity of Demand and Price Increases. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on DRI•WEFA's multivariate regression analysis using data from 1965 to 1999, the long run price elasticity of consumption for the entire population is -0.31, that is, a 1.0% increase in the price of cigarettes decreases consumption by 0.31%.

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 the agreements with the Previously Settled States. The cigarette manufacturers have since increased wholesale prices on seven occasions: in August 1999 by $0.18 per pack, in January 2000 by $0.13 per pack, in July 2000 by $0.06 per pack, in December 2000 by $0.14 per pack, on April 25, 2001 by $0.14 per pack, on October 29, 2001 by $0.05 per pack, and most recently on April 1, 2002 by $0.12 per pack.

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, Maine, Rhode Island, Washington, West Virginia and Wisconsin all increased their tax on cigarettes. In January 2002, the federal excise tax increased by $0.05 per pack. In April 2002 excise tax increases went into effect in New York and Connecticut, and on July 1, 2002, excise tax increases went into effect in Illinois, Indiana, Kansas, Louisiana, Maryland, New Jersey, New York City, Ohio, Pennsylvania, Rhode Island, Utah and Vermont. Also, the DRI•WEFA Report states that Hawaii, Massachusetts, Michigan, Tennessee and Nebraska will increase excise taxes later in 2002. These increases ranged from $0.07 to $1.42 per pack. The foregoing states are among up to 30 states which have considered increases in excise taxes as a response to budget shortfalls following the 2001 recession. The average state excise tax is now almost $0.60 per pack. As a result of these increases, DRI•WEFA estimates that average retail prices across the U.S. had risen, in May 2002, to approximately $3.64 per pack. For the year 2000, DRI•WEFA estimates that the average price per pack was $3.20, representing a nominal growth in the price of cigarettes of 11.0% from 1999. For 2001, DRI•WEFA estimates that the average price was $3.45 per pack.

In addition to the excise tax increases referred to above, DRI•WEFA's base case forecast assumes that California and two smaller states also enact excise tax increases in the second half of 2002. This will result in an average price per pack that increases from $3.50 at the start of 2002 to $3.80 in July, and to over $4.00 in 2003. Over the longer term, DRI•WEFA's forecast expects price increases to continue to exceed the general rate of inflation due to costs related to the MSA and increases in excise taxes, among other reasons.

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 their cost of smoking. Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found that cigarette consumption in the United States increases as disposable income increases. However, a few studies have found that cigarette consumption decreases as disposable income increases. Based on its multivariate regression analysis using data from 1965 to 1999, DRI•WEFA found that the income elasticity of consumption is 0.27; in other words, 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, almost all adult smokers first used cigarettes by high school and very little first use occurs after age 20. One study examines cohort effects (intertemporal correlation) of youth smoking on adult smoking. 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 current teen cohorts will face as they age.

DRI•WEFA 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. The percentage, after falling since the early 1970's began to increase in 1990 and increased through the decade. DRI•WEFA assumes that this recent trend peaked and that in the late 1990's youth smoking has resumed its longer-term decline.

Trend Over Time. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by DRI•WEFA, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. DRI•WEFA'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.

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 1964 United States Surgeon General's Report 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, beginning November 1, 1970, 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. 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 DRI•WEFA's model may represent the cumulative effect of various health warnings since 1966.

Smoking Bans in Public Places. Beginning in the 1970's, numerous states have passed laws banning smoking in public places as well as in private workplaces. As of 1999, 48 states and the District of Columbia required smoke-free indoor air to some degree, or in some public places. Based on its regression analysis using data from 1965 to 1999, DRI•WEFA found that the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. DRI•WEFA estimates that the restrictions instituted beginning in the late 1970's has reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. The trend variable included in DRI•WEFA's econometric analysis is likely to incorporate some part of the cumulative impact of the various smoking bans and restrictions.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General and the American Medical Association 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," 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 addition, regulation of advertising, clean air regulations, restrictions 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 of up to 25% of their annual MSA settlement proceeds, which is far higher than the approximately 9% allocated from the first year's MSA settlement payments.

The Surgeon General's Report documents evidence of the effectiveness of five major modalities for reducing tobacco use. Educational strategies are shown to be effective in postponing or preventing adolescent smoking. Pharmacologic treatment of nicotine addiction, combined with behavioral support, can enhance abstinence efforts. Regulation of advertising and promotional activities of manufacturers can reduce smoking, particularly among youth. Clean air regulations and restricted minor's access contribute to lessening smoking prevalence. And excise tax increases will reduce cigarette consumption. Further support for the efficacy of such programs is provided in an analysis by Farrelly, Pechacek and Chaloupka. They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%.

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. 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 growers 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 calls 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.

DRI•WEFA's research has indicated (and its 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. DRI•WEFA's 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. Similarly, the United States Department of Justice has indicated that as part of its lawsuit against tobacco companies, it may seek to require graphic health warnings covering 50% of cigarette packs, prohibit in-store promotions, and require that all advertising and packaging be black-and-white. DRI•WEFA goes on to state that, as the prevalence of smoking declines, it is likely that the achievement of further declines requires either greater levels of spending, or more effective programs, which DRI•WEFA views as the common economic principle of diminishing returns.

In August 2000, New York State mandated that by the year 2003 manufacturers provide only cigarettes that self-extinguish. DRI•WEFA expects that by that year an agreement will have been reached on a nationwide standard. DRI•WEFA does not believe that either the New York statute or a nationwide agreement will impact consumption noticeably. DRI•WEFA believes that this will probably raise the cost of manufacture slightly, but is viewed by DRI•WEFA as the continuation of a long series of government actions that contribute to the trend decline in consumption and thus have been incorporated into DRI•WEFA's model.

Similarly, on January 16, 2001, Vector Group Ltd. announced plans to introduce a virtually nicotine-free cigarette. This non-addictive product might be used as a tool to quit or reduce smoking. DRI•WEFA views 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 its forecast, DRI•WEFA's expects the per capita cigarette consumption to continue to decline.

MSA PAYMENTS MADE TO TSASC TO DATE

The MSA Escrow Agent has disbursed to TSASC its allocable portions of the Initial Payments due in 2000, 2001 and 2002, and the Annual Payments due in 2000, 2001 and 2002 under the MSA. These payments have totaled $652.1 million. Under the MSA, the information on which computation of Initial Payments and Annual Payments by the MSA Auditor is based is confidential and may not be used for purposes other than those stated in the MSA.

With respect to each of the Initial Payments and the Annual Payments made to date, the following tables set forth: (i) The amount of each such payment as projected by TSASC in connection with the issuance of its Series 1999-1 Bonds, (ii) the amount of each such payment actually received by TSASC, and (iii) the positive or (negative) variance between the amount projected and the amount actually received by TSASC.

Initial Payments*

Date	TSASC Projected Payments**	TSASC's Actual Receipts	Variance
January 2000	$73,882,460	$73,269,242	(613,218)
January 2001	$75,874,244	$66,051,895	(9,822,349)
January 2002	$77,941,662	$68,099,255	(9,842,407)

Annual Payments

Date	TSASC Projected Payments**	TSASC's Actual Receipts	Variance
April 2000	$121,534,157	$117,706,339	(3,827,818)
April 2001	$138,678,415	$138,240,751	(437,664)
April 2002	$185,194,253	$186,878,333	1,684,080

* In addition, the upfront Initial Payment of $84,042,678 was received by TSASC on December 14, 1999.

** Projected as of the issuance of the Series 1999-1 Bonds.

The variance shown above was due primarily to lower OPM volume than originally forecast, the application of NPM adjustments not previously assumed, adjustments made to correct for prior overpayments by the PMs and certain disputed payments. For example, approximately $3.6 million of the variance in the April 2000 payment was due to the application of the NPM Adjustment. Approximately $7.7 million of the variance in the January 2001 payment was due to the retroactive increase in the NPM Adjustment to the April 2000 Payment. Approximately $7 million of the variance in the January 2002 payment was due to a disputed payment by B&W, the majority of which was subsequently released in April of 2002.

In addition to the payments shown above, TSASC has received approximately $1.9 million, in between regularly scheduled payments, representing its share of certain offsets and adjustments made in favor of the Settling States as calculated by the MSA Auditor.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the headings "Initial Payments," "Annual Payments" and "Adjustments to Payments." Certain of the Settling States and the PMs are disputing the calculations of the Initial Payments for 2000, 2001 and 2002 and Annual Payments for 2000, 2001 and 2002. 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.

SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION

Introduction

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

Cash Flow Assumptions

In calculating projections of Collections to be received by TSASC, different assumptions of cigarette consumption in the United States, including the forecast developed by DRI•WEFA described as the Base Case Forecast, were applied to calculate the Initial Payment to be made by the OPMs on or before January 10, 2003 (the last Initial Payment) and Annual Payments to be made by the PMs pursuant to the MSA. No calculations of Strategic Contribution Payments are provided since these payments are not allocated to the City under the Decree and thus are not available to TSASC. The calculations of Initial and Annual Payments required to be made were performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the relative market share for each of the PMs remains constant throughout the forecast period at 94.0% for the OPMs, 4.5% for the SPMs and 1.5% for the NPMs.* It was further assumed that each company that is currently a PM remains such throughout the term of the Program Bonds.

In applying consumption forecasts from the DRI•WEFA Report, it was assumed that United States consumption, which was forecasted by DRI•WEFA, 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 DRI•WEFA 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.

Initial Payment

For each projection, the amount of the Initial Payment due from the OPMs on January 10, 2003 was calculated by applying the adjustments applicable to the Initial Payments in accordance with the MSA as follows:

Volume Adjustment. First, the Volume Adjustment was applied to the base amount for the Initial Payment due on January 10, 2003 set forth in the MSA. The Volume Adjustment was calculated 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 for the Income Adjustment. See "SUMMARY OF THE MSA—Adjustments to Payments—Volume Adjustment" for a description of the formula used to calculate the Volume Adjustment.

Non-Settling States Reduction. The Non-Settling States Reduction was not applied to the Initial Payment due on January 10, 2003, 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 New York State will remain a party to the MSA.

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

Offset for Miscalculated or Disputed Payments. The Cash Flow Assumptions include an assumption that there will be no adjustments to the Initial Payment due on January 10, 2003 due to miscalculated or disputed payments.

State Allocation Percentage for the State of New York. The amount of the Initial Payment due on January 10, 2003, after application of the Volume Adjustment, was multiplied by the State Allocation Percentage for the State of New York pursuant to the MSA (equal to 12.7620310%) in order to determine the portion of that Initial Payment to be made by the OPMs that is to be allocated to the State.

Consent Decree Allocation Percentage for the City. The amount of the Initial Payment to be allocated to the State, calculated as described in the preceding paragraph, was multiplied by the percentage of such payment that is allocated to the City pursuant to the Decree (equal to 26.670%) in order to determine the amount of the Initial Payment assumed to be received by TSASC on January 10, 2003.

The Initial Payment due to be received by TSASC on January 10, 2003, calculated in accordance with the Cash Flow Assumptions is projected to be $73,589,443.

Annual Payments

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

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments set forth in the MSA. For payments due in 2000, 2001 and 2002, the Inflation Adjustment was 3.0%, 3.4% and 3.0% respectively, which was calculated based on 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). For all subsequent years, the Inflation Adjustment was assumed to be the minimum provided in the MSA, 3.0% per year, compounded annually, for the entire forecast period.

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

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

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

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

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments payable to any state that enacts and diligently enforces a Model Statute or 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 Model Statute that is not held to be unenforceable. For a discussion of the Model Statutes generally and of the New York Qualifying Statute, see "SUMMARY OF THE MSA—MSA Provisions Relating to Model/Qualifying Statutes" herein. For a description of the opinion of Transaction Counsel to be delivered to TSASC with respect to the Model Statute, see "LEGAL CONSIDERATIONS—Model Statute Constitutionality" herein.

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

Federal Tobacco Legislation Offset. The Cash Flow Assumptions include an assumption that the Federal Tobacco Legislation Offset will have no effect on payments under the MSA. As of the date hereof, no legislation has been introduced in the United States Congress that would cause this offset to apply. Unless federal legislation is enacted on or prior to November 30, 2002, this offset will not apply.

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 4.5%. Because the 4.5% 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 in each year. Based on the Cash Flow Assumptions and the SPM Payment formula, the aggregate payments to be made by the PMs will be lower in future years than if the relative aggregate market share of the OPMs were 97%, their aggregate estimated 1997 market share.

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

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

Projections of TSRs

The following table presents the projections of the Initial Payment, Annual Payments, and total payments to be received by TSASC in each year through 2042, calculated in accordance with the Cash Flow Assumptions and using DRI•WEFA's Base Case Forecast. DRI•WEFA's Base Case Forecast for United States cigarette consumption is set forth herein under "DRI•WEFA REPORT." See Appendix A hereto for a discussion of the assumptions underlying the projections of cigarette consumption contained in the DRI•WEFA Report.

Projection of Total Payments to be Received by TSASC

Date	DRI•WEFA Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	TSASC's Allocation of OPM Annual Payments 3.4036337%	TSASC's Allocation of SPM Annual Payments 3.4036337%	Total Payments to TSASC
2003	391,850,000,000	368,339,000,000	$6,500,000,000	$ 844,218,167	$ (1,465,831,685)	$ (731,859,117)	$ 5,146,527,365	$175,168,938	$2,926,684	$251,685,065*
2004	385,270,000,000	362,153,800,000	8,000,000,000	1,310,208,876	(2,058,548,220)	(902,831,752)	6,348,828,904	216,090,878	3,610,398	219,701,276
2005	380,680,000,000	357,839,200,000	8,000,000,000	1,589,515,143	(2,242,508,124)	(914,702,374)	6,432,304,645	218,932,086	3,657,869	222,589,955
2006	375,670,000,000	353,129,800,000	8,000,000,000	1,877,200,597	(2,397,585,995)	(931,212,018)	6,548,402,584	222,883,635	3,723,890	226,607,525
2007	370,500,000,000	348,270,000,000	8,000,000,000	2,173,516,615	(2,568,225,534)	(946,858,740)	6,658,432,341	226,628,645	3,786,461	230,415,106
2008	365,000,000,000	343,100,000,000	8,139,000,000	2,521,789,910	(2,797,977,269)	(962,201,916)	6,900,610,725	234,871,510	3,914,674	238,786,184
2009	358,900,000,000	337,366,000,000	8,139,000,000	2,841,613,607	(2,998,880,058)	(976,754,714)	7,004,978,835	238,423,818	3,973,881	242,397,699
2010	353,270,000,000	332,073,800,000	8,139,000,000	3,171,032,015	(3,222,461,276)	(989,706,408)	7,097,864,331	241,585,300	4,026,575	245,611,875
2011	347,650,000,000	326,791,000,000	8,139,000,000	3,510,332,976	(3,446,154,616)	(1,003,853,747)	7,199,324,613	245,038,636	4,084,132	249,122,769
2012	341,810,000,000	321,301,400,000	8,139,000,000	3,859,812,965	(3,680,136,961)	(1,017,987,628)	7,300,688,377	248,488,688	4,141,635	252,630,323
2013	335,900,000,000	315,746,000,000	8,139,000,000	4,219,777,354	(3,930,322,444)	(1,031,421,685)	7,397,033,226	251,767,913	4,196,291	255,964,205
2014	329,950,000,000	310,153,000,000	8,139,000,000	4,590,540,675	(4,193,932,658)	(1,044,534,413)	7,491,073,604	254,968,703	4,249,640	259,218,343
2015	324,710,000,000	305,227,400,000	8,139,000,000	4,972,426,895	(4,470,837,907)	(1,057,381,328)	7,583,207,659	258,104,609	4,301,907	262,406,516
2016	319,480,000,000	300,311,200,000	8,139,000,000	5,365,769,702	(4,742,013,164)	(1,072,331,430)	7,690,425,107	261,753,898	4,362,731	266,116,629
2017	314,110,000,000	295,263,400,000	8,139,000,000	5,770,912,793	(5,025,165,790)	(1,087,259,862)	7,797,487,141	265,397,898	4,423,466	269,821,364
2018	308,830,000,000	290,300,200,000	9,000,000,000	6,842,842,068	(5,888,231,921)	(1,101,643,526)	8,852,966,621	301,322,552	4,956,121	306,278,674
2019	303,490,000,000	285,280,600,000	9,000,000,000	7,318,127,330	(6,231,743,854)	(1,116,226,441)	8,970,157,034	305,311,285	5,021,727	310,333,012
2020	298,550,000,000	280,637,000,000	9,000,000,000	7,807,671,150	(6,592,520,174)	(1,130,476,711)	9,084,674,264	309,209,032	5,085,837	314,294,869
2021	293,590,000,000	275,974,600,000	9,000,000,000	8,311,901,284	(6,955,923,363)	(1,146,061,560)	9,209,916,361	313,471,814	5,155,951	318,627,765
2022	288,830,000,000	271,500,200,000	9,000,000,000	8,831,258,323	(7,335,888,148)	(1,161,487,636)	9,333,882,538	317,691,169	5,225,350	322,916,519
2023	284,100,000,000	267,054,000,000	9,000,000,000	9,366,196,073	(7,725,276,551)	(1,177,595,097)	9,463,324,424	322,096,896	5,297,815	327,394,712
2024	279,720,000,000	262,936,800,000	9,000,000,000	9,917,181,955	(8,130,326,855)	(1,193,745,301)	9,593,109,799	326,514,315	5,370,473	331,884,787
2025	275,390,000,000	258,866,600,000	9,000,000,000	10,484,697,413	(8,539,519,865)	(1,211,266,319)	9,733,911,229	331,306,680	5,449,297	336,755,977
2026	271,140,000,000	254,871,600,000	9,000,000,000	11,069,238,336	(8,964,003,764)	(1,228,979,296)	9,876,255,275	336,151,550	5,528,985	341,680,534
2027	267,000,000,000	250,980,000,000	9,000,000,000	11,671,315,486	(9,403,068,409)	(1,247,019,347)	10,021,227,730	341,085,881	5,610,144	346,696,025
2028	262,940,000,000	247,163,600,000	9,000,000,000	12,291,454,950	(9,855,873,475)	(1,265,537,687)	10,170,043,788	346,151,034	5,693,455	351,844,490
2029	258,940,000,000	243,403,600,000	9,000,000,000	12,930,198,599	(10,323,986,318)	(1,284,420,830)	10,321,791,451	351,315,969	5,778,407	357,094,376
2030	255,010,000,000	239,709,400,000	9,000,000,000	13,588,104,557	(10,808,690,871)	(1,303,588,452)	10,475,825,234	356,558,715	5,864,640	362,423,354
2031	251,030,000,000	235,968,200,000	9,000,000,000	14,265,747,694	(11,310,032,005)	(1,323,099,207)	10,632,616,482	361,895,314	5,952,415	367,847,730
2032	247,160,000,000	232,330,400,000	9,000,000,000	14,963,720,124	(11,834,046,305)	(1,342,350,573)	10,787,323,246	367,160,966	6,039,024	373,199,990
2033	243,360,000,000	228,758,400,000	9,000,000,000	15,682,631,728	(12,374,064,137)	(1,362,148,151)	10,946,419,440	372,576,017	6,128,090	378,704,108
2034	239,560,000,000	225,186,400,000	9,000,000,000	16,423,110,680	(12,932,385,823)	(1,382,306,888)	11,108,417,968	378,089,854	6,218,781	384,308,635
2035	235,390,000,000	221,266,600,000	9,000,000,000	17,185,804,000	(13,513,070,153)	(1,402,449,217)	11,270,284,631	383,599,202	6,309,399	389,908,601
2036	231,650,000,000	217,751,000,000	9,000,000,000	17,971,378,120	(14,136,283,455)	(1,420,417,147)	11,414,677,518	388,513,807	6,390,234	394,904,041
2037	227,990,000,000	214,310,600,000	9,000,000,000	18,780,519,464	(14,761,592,779)	(1,440,761,224)	11,578,165,461	394,078,338	6,481,758	400,560,096
2038	224,450,000,000	210,983,000,000	9,000,000,000	19,613,935,048	(15,407,264,693)	(1,461,538,190)	11,745,132,165	399,761,273	6,575,231	406,336,503
2039	220,750,000,000	207,505,000,000	9,000,000,000	20,472,353,099	(16,071,542,017)	(1,483,023,098)	11,917,787,985	405,637,844	6,671,888	412,309,732
2040	217,150,000,000	204,121,000,000	9,000,000,000	21,356,523,692	(16,771,216,049)	(1,503,440,717)	12,081,866,926	411,222,490	6,763,744	417,986,234
2041	213,660,000,000	200,840,400,000	9,000,000,000	22,267,219,403	(17,492,350,632)	(1,524,418,815)	12,250,449,956	416,960,439	6,858,121	423,818,560
2042	210,090,000,000	197,484,600,000	9,000,000,000	23,205,235,985	(18,234,798,311)	(1,546,061,774)	12,424,375,900	422,880,241	6,955,489	429,835,730

* Includes the projected $73,589,443 Initial Payment due January 10, 2003.

Interest Earnings

The Cash Flow Assumptions assume that the Indenture Trustee will receive ten days after January 10, 2003, TSASC's share of the Initial Payment owed by the OPMs on or before that date. It is also assumed that the Indenture Trustee will receive ten days after April 15 of each year TSASC's share of the Annual Payments owed by the PMs in 2003 and each year thereafter. Interest is assumed to be earned on the Initial Payment and Annual Payments received by the Indenture Trustee at the rate of 3% per annum until the applicable Distribution Date, except in the case of amounts that are expected to be paid earlier to the holder of the Residual Certificate as permitted by the Indenture. Interest earnings have been assumed to begin accruing upon receipt by the Indenture Trustee of the Initial Payment and Annual Payments.

All amounts on deposit in the Accounts established under the Indenture, including the Liquidity Reserve Account, are assumed to be invested at the rate of 3% per annum, except for the capitalized interest on deposit in the Debt Service Account, which is assumed to be invested at the rate of 1.50%.

Bond Structuring Methodology and Other Assumptions

Program Bond Issuance. The Cash Flow Assumptions assume approximately $2.8 billion of aggregate Program Bond issuance. Principal Installments and Super Sinker Redemptions have been structured for the Program Bonds which result in Debt Service that is equal to or less than the amounts shown in the schedules of Principal Installment Annual Debt Service and Super Sinker Redemption Annual Debt Service provided herein. See "THE SERIES 2002-1 BONDS—Annual Program Debt Service Schedule".

TIFIA Loan Assumptions. Upon full disbursement, the TIFIA loan is assumed to have a maximum issuance amount of $160,763,445 (including capitalized interest thereon) and a maximum Liquidity Reserve of $10,811,793. It is further assumed that the TIFIA loan is currently outstanding in the amount of $42,564,993.30 with the Liquidity Reserve funded at $3,150,783.36. All information regarding the TIFIA loan was provided by TSASC as of April 5, 2002.

Issuance Dates and Amounts. In addition to the issuance of the $500,000,000 Series 2002-1 Bonds on August 15, 2002, it is assumed that TSASC will issue approximately $715 million of Program Bonds in April of 2003 and approximately $717 million in April of 2004.

Serial Maturities. The schedule of Serial Maturities for the Series 2002-1 Bonds is set forth on the inside front cover hereof.

Mandatory Sinking Fund Installments. The schedules of Mandatory Sinking Fund Installments for the Series 2002-1 Bonds are as indicated under "THE BONDS—Mandatory Sinking Fund Installments and Super Sinker Redemptions" herein.

Super Sinker Term Bond Maturities. The Series 2002-1 Super Sinker Term Bonds mature as set forth on the inside front cover hereof.

Super Sinker Redemptions. The schedule of Super Sinker Redemptions for the Series 2002-1 Bonds expected to be paid under the DRI•WEFA Base Case Forecast (and which will otherwise be paid to the extent of available Collections), is as indicated under "THE BONDS—Mandatory Sinking Fund Installments and Super Sinker Redemptions" herein.

Capitalized Interest. Interest on the Series 2002-1 Bonds will be capitalized to July 15, 2003. Interest on the April 2003 and April 2004 transactions is assumed to be capitalized to January 15, 2004 and January 15, 2005, respectively.

Liquidity Reserve Account. Prior to the issuance of the Series 2002-1 Bonds, the Liquidity Reserve Account is funded at $56,820,277.12 for the outstanding Program Bonds. An additional $7,661,009.64 is assumed to be deposited from the proceeds of the TIFIA loan as it is disbursed. Upon the issuance of the Series 2002-1 Bonds, a deposit of $41,718,502.44 will be made to the Liquidity Reserve Account, which will bring its balance to the Liquidity Reserve Requirement. Upon the issuance of Additional Bonds, the Cash Flow Assumptions assume that the Liquidity Reserve Account will be fully funded at maximum annual Principal Installments Debt Service on all Program Bonds outstanding as of the date of issuance.

Operating Expense Assumptions. Annual operating expenses of TSASC have been assumed at the Operating Cap of $1,000,000 in 2000 and inflated at 3% per year thereafter. No arbitrage rebate expense was assumed since it has been assumed that the yield on TSASC's investments will not exceed the yield on the Bonds.

Interest Rates. The Series 2002-1 Bonds were assumed to bear interest at the rates set forth on the page immediately following the inside front cover hereof. The subsequent transactions are assumed to bear interest at a rate of 7.0%.

Miscellaneous. The Cash Flow Assumptions assume that there is no optional redemption of the Bonds, that no Event of Default occurs and that no Trapping Event occurs. It is further assumed that all Distribution Dates occur on the fifteenth day of each July and January, whether or not such date is a Business Day.

Set forth below are schedules showing the Principal Installments Debt Service as well as the debt service on Serial Maturities and Super Sinker Redemptions for each series of outstanding Program Bonds as well as estimates of the Principal Installments and Super Sinker Redemptions to be structured for future series of Program Bonds. Actual Principal Installments and Super Sinker Redemptions of future series of Program Bonds will be different than those set forth herein as a result of various factors including, without limitation, prevailing market conditions and interest rates, and will be determined at the time of issuance of such Program Bonds.

Estimated Interest and Principal Installments on Program Bonds (1)

	Series 1999-1 (3)		TIFIA Loan (4)		Series 2002-1		Series 2003-1		Series 2004-1		Total All Program Bonds		
Year (2)	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Debt Service
2003	$ 0	$ 42,373,978	$ 0	$ 5,534,253	$ 0	$ 13,741,090	$ 0	$ 0	$ 0	$ 0	$ 0	$ 61,649,321	$ 61,649,321
2004	0	42,373,978	0	8,049,526	0	27,482,180	0	50,050,000	0	0	0	127,955,684	127,955,684
2005	0	42,373,978	0	8,874,142	0	27,482,180	0	50,050,000	0	50,192,100	0	178,972,400	178,972,400
2006	0	42,373,978	0	8,874,142	1,425,000	27,460,805	540,000	50,031,100	0	50,192,100	1,965,000	178,932,125	180,897,125
2007	0	42,373,978	0	8,874,142	1,420,000	27,415,290	2,715,000	49,917,175	2,715,000	50,097,075	6,850,000	178,677,660	185,527,660
2008	5,435,000	42,238,103	0	8,874,142	7,735,000	27,246,119	1,405,000	49,772,975	1,405,000	49,952,875	15,980,000	178,084,213	194,064,213
2009	6,690,000	41,932,721	0	8,874,142	8,390,000	26,933,288	1,910,000	49,656,950	1,910,000	49,836,850	18,900,000	177,233,951	196,133,951
2010	7,580,000	41,564,968	0	8,874,142	9,125,000	26,571,581	2,495,000	49,502,775	2,495,000	49,682,675	21,695,000	176,196,141	197,891,141
2011	8,275,000	41,146,001	0	8,874,142	6,830,000	26,198,388	4,775,000	49,248,325	4,775,000	49,428,225	24,655,000	174,895,081	199,550,081
2012	8,405,000	40,698,655	0	8,874,142	10,900,000	25,773,850	3,880,000	48,945,400	3,880,000	49,125,300	27,065,000	173,417,347	200,482,347
2013	9,215,000	40,218,615	0	8,874,142	7,470,000	25,323,175	4,915,000	48,637,575	6,115,000	48,775,475	27,715,000	171,828,982	199,543,982
2014	10,045,000	39,680,998	0	8,874,142	12,135,000	24,814,375	4,285,000	48,315,575	4,285,000	48,411,475	30,750,000	170,096,565	200,846,565
2015	7,390,000	39,183,333	0	8,874,142	11,480,000	24,195,300	5,445,000	47,975,025	5,485,000	48,069,525	29,800,000	168,297,325	198,097,325
2016	8,060,000	38,733,111	3,372,825	8,780,544	11,925,000	23,551,663	4,965,000	47,610,675	5,005,000	47,702,375	33,327,825	166,378,367	199,706,192
2017	9,045,000	38,229,521	3,559,005	8,588,926	14,960,000	22,812,325	4,045,000	47,295,325	4,085,000	47,384,225	35,694,005	164,310,323	200,004,328
2018	15,640,000	37,493,494	3,755,462	8,387,002	18,540,000	21,891,075	10,110,000	46,799,900	10,150,000	46,886,000	58,195,462	161,457,471	219,652,933
2019	17,160,000	36,509,494	3,962,763	8,173,932	19,550,000	20,843,600	10,620,000	46,074,350	10,660,000	46,157,650	61,952,763	157,759,026	219,711,789
2020	16,925,000	35,486,944	4,181,508	7,949,419	20,615,000	19,739,063	10,330,000	45,341,100	10,370,000	45,421,600	62,421,508	153,938,125	216,359,633
2021	18,460,000	34,411,744	4,412,327	7,711,859	21,740,000	18,574,300	10,820,000	44,600,850	10,860,000	44,678,550	66,292,327	149,977,302	216,269,629
2022	20,315,000	33,209,450	4,655,887	7,461,521	22,845,000	17,348,213	11,445,000	43,821,575	11,485,000	43,896,475	70,745,887	145,737,233	216,483,120
2023	21,415,000	31,905,388	4,912,892	7,197,364	23,855,000	16,063,963	11,975,000	43,001,875	12,015,000	43,073,975	74,172,892	141,242,564	215,415,456
2024	22,610,000	30,529,606	5,184,084	6,919,020	25,200,000	14,714,950	12,895,000	42,131,425	12,935,000	42,200,725	78,824,084	136,495,727	215,319,811
2025	23,085,000	29,101,638	5,470,245	6,624,502	26,120,000	13,271,000	14,490,000	41,172,950	14,530,000	41,239,450	83,695,245	131,409,539	215,104,784
2026	24,190,000	27,624,294	5,772,203	6,314,142	26,945,000	11,745,381	14,495,000	40,158,475	14,535,000	40,222,175	85,937,203	126,064,467	212,001,670
2027	26,450,000	26,041,794	6,090,828	5,986,650	28,280,000	10,157,663	15,160,000	39,120,550	15,200,000	39,181,450	91,180,828	120,488,106	211,668,934
2028	25,630,000	24,414,294	6,427,042	5,641,569	29,520,000	8,495,913	15,610,000	38,043,600	15,650,000	38,101,700	92,837,042	114,697,075	207,534,117
2029	26,290,000	22,791,794	6,781,815	5,276,435	30,660,000	6,765,738	15,855,000	36,942,325	15,895,000	36,997,625	95,481,815	108,773,917	204,255,732
2030	27,055,000	21,124,763	7,156,171	4,891,662	32,305,000	4,955,494	16,765,000	35,800,625	16,805,000	35,853,125	100,086,171	102,625,668	202,711,839
2031	28,895,000	19,376,325	7,551,192	4,485,649	33,840,000	3,053,825	17,425,000	34,603,975	17,465,000	34,653,675	105,176,192	96,173,449	201,349,641
2032	30,850,000	17,509,294	7,968,017	4,057,830	36,190,000	1,040,463	19,170,000	33,323,150	19,210,000	33,370,050	113,388,017	89,300,786	202,688,803
2033	32,810,000	15,519,919	8,407,852	3,605,151	0	0	39,410,000	31,272,850	39,450,000	31,316,950	120,077,852	81,714,869	201,792,721
2034	35,400,000	13,367,144	8,871,965	3,128,122	0	0	42,630,000	28,401,450	42,670,000	28,442,750	129,571,965	73,339,466	202,911,431
2035	37,915,000	11,031,141	9,361,698	2,624,762	0	0	45,095,000	25,331,075	45,135,000	25,369,575	137,506,698	64,356,553	201,863,251
2036	40,700,000	8,525,288	9,878,464	2,094,368	0	0	47,570,000	22,087,800	47,610,000	22,123,500	145,758,464	54,830,955	200,589,419
2037	39,190,000	5,978,794	10,423,755	1,533,152	0	0	49,865,000	18,677,575	49,905,000	18,710,475	149,383,755	44,899,995	194,283,750
2038	37,085,000	3,547,528	10,999,146	941,749	0	0	52,150,000	15,107,050	52,190,000	15,137,150	152,424,146	34,733,477	187,157,623
2039	37,105,000	1,182,722	11,606,299	317,701	0	0	49,790,000	11,539,150	49,830,000	11,566,450	148,331,299	24,606,023	172,937,322
2040	0	0	0	0	0	0	66,775,000	7,459,375	66,840,000	7,483,000	133,615,000	14,942,375	148,557,375
2041	0	0	0	0	0	0	47,225,000	3,469,375	47,375,000	3,485,475	94,600,000	6,954,850	101,554,850
2042	0	0	0	0	0	0	25,950,000	908,250	26,105,000	913,675	52,055,000	1,821,925	53,876,925
Total:	$685,315,000	$1,102,178,760	$160,763,445	$239,892,373	$500,000,000	$565,662,245	$715,000,000	$1,462,199,550	$717,030,000	$1,415,333,500	$2,778,108,445	$4,785,266,428	$7,563,374,873

(1) Excludes capitalized interest.
(2) The year shown is the year in which Revenues are received and residuals are released to the Residual Certificate holder. Such Revenues are used to pay Debt Service in July of the year shown and January of the following year.
(3) Excludes $23,965,000 of Principal Installments already paid through Super Sinker Redemptions.
(4) Assumes the full amount of the TIFIA loan is drawn and includes an estimate for capitalized interest. To date, only $42,564,993.30 has been drawn. Estimates of principal and interest payments are based upon projected draws and were provided by TSASC as of April 5, 2002. Payments of interest on the TIFIA loan are calculated on an actual/actual basis at a rate 5.52% per annum.

Estimated Interest, Serial Maturities and Super Sinker Redemptions on Program Bonds (1)

Year (2)	Series 1999-1 (3) Principal	Series 1999-1 (3) Interest	TIFIA Loan (4) Principal	TIFIA Loan (4) Interest	Series 2002-1 Principal	Series 2002-1 Interest	Series 2003-1 Principal	Series 2003-1 Interest	Series 2004-1 Principal	Series 2004-1 Interest	Total All Program Bonds Principal	Total All Program Bonds Interest	Total All Program Bonds Debt Service
2003	$ 8,515,000	$ 42,161,103	$ 0	$ 5,534,253	$ 33,795,000	$ 12,811,728	$ 0	$ 0	$ 0	$ 0	$ 42,310,000	$ 60,507,083	$ 102,817,083
2004	6,520,000	41,780,061	0	8,049,526	14,235,000	25,231,993	22,620,000	49,258,300	0	0	43,375,000	124,319,880	167,694,880
2005	7,345,000	41,419,089	2,366,334	8,808,295	4,935,000	24,704,818	5,715,000	48,266,575	4,085,000	50,049,125	24,446,334	173,247,901	197,694,235
2006	8,060,000	41,009,670	2,496,955	8,674,038	6,480,000	24,408,718	6,235,000	47,848,325	3,905,000	49,769,475	27,176,955	171,710,226	198,887,181
2007	8,770,000	40,554,855	2,634,787	8,532,371	5,800,000	24,103,740	5,655,000	47,432,175	6,885,000	49,391,825	29,744,787	170,014,966	199,759,753
2008	10,545,000	40,024,588	2,780,228	8,383,095	12,625,000	23,679,644	4,495,000	47,076,925	5,900,000	48,944,350	36,345,228	168,108,601	204,453,829
2009	11,685,000	39,398,051	2,933,696	8,225,144	13,495,000	23,091,950	5,120,000	46,740,400	6,645,000	48,505,275	39,878,696	165,960,821	205,839,517
2010	13,050,000	38,679,812	3,095,636	8,058,698	14,550,000	22,440,669	5,965,000	46,352,425	7,630,000	48,005,650	44,290,636	163,537,254	207,827,890
2011	13,965,000	37,879,919	3,266,515	7,883,064	12,395,000	21,765,250	8,450,000	45,847,900	10,260,000	47,379,500	48,336,515	160,755,633	209,092,148
2012	15,030,000	37,012,894	3,446,827	7,697,997	16,830,000	21,024,600	7,665,000	45,283,875	9,615,000	46,683,875	52,586,827	157,703,241	210,290,068
2013	16,305,000	36,072,844	3,637,092	7,502,175	14,110,000	20,228,250	9,810,000	44,672,250	13,190,000	45,885,700	57,052,092	154,361,219	211,413,311
2014	17,615,000	35,055,244	3,837,859	7,295,821	19,250,000	19,341,188	9,330,000	44,002,350	11,625,000	45,017,175	61,657,859	150,711,777	212,369,636
2015	18,860,000	33,937,419	4,049,709	7,078,076	18,945,000	18,321,163	10,930,000	43,293,250	13,385,000	44,141,825	66,169,709	146,771,732	212,941,441
2016	20,595,000	32,704,450	4,273,253	6,848,637	20,215,000	17,244,263	11,420,000	42,511,000	14,060,000	43,181,250	70,563,253	142,489,599	213,052,852
2017	22,400,000	31,360,856	4,509,137	6,605,864	24,245,000	16,021,613	13,075,000	41,653,675	12,620,000	42,247,450	76,849,137	137,889,458	214,738,595
2018	30,810,000	29,698,044	4,758,041	6,350,034	29,690,000	14,531,581	21,815,000	40,432,525	21,325,000	41,059,375	108,398,041	132,071,559	240,469,600
2019	33,315,000	27,694,138	5,020,685	6,080,081	31,400,000	12,805,538	23,190,000	38,857,350	22,665,000	39,519,725	115,590,685	124,956,831	240,547,516
2020	35,945,000	25,529,763	5,297,827	5,795,630	34,085,000	10,922,844	24,920,000	37,173,500	24,355,000	37,874,025	124,602,827	117,295,762	241,898,589
2021	37,365,000	23,238,825	5,590,267	5,494,650	36,220,000	8,901,575	26,660,000	35,368,200	26,050,000	36,109,850	131,885,267	109,113,100	240,998,367
2022	39,105,000	20,849,138	5,898,849	5,177,480	38,145,000	6,763,581	28,310,000	33,444,250	27,650,000	34,230,350	139,108,849	100,464,799	239,573,648
2023	40,885,000	18,349,450	6,224,466	4,842,803	39,360,000	4,535,313	29,020,000	31,437,700	28,305,000	32,271,925	143,794,466	91,437,190	235,231,656
2024	42,695,000	15,737,575	6,568,056	4,490,151	39,680,000	2,262,913	28,390,000	29,428,350	27,620,000	30,314,550	144,953,056	82,233,538	227,186,594
2025	44,680,000	12,979,181	6,930,613	4,117,006	19,515,000	561,056	38,990,000	27,070,050	38,155,000	28,012,425	148,270,613	72,739,718	221,010,331
2026	45,270,000	10,112,025	7,313,183	3,723,790	0	0	49,875,000	23,959,775	48,975,000	24,962,875	151,433,183	62,758,465	214,191,648
2027	46,150,000	7,198,013	7,716,871	3,308,869	0	0	48,420,000	20,519,450	47,445,000	21,588,175	149,731,871	52,614,507	202,346,378
2028	46,945,000	4,230,609	8,142,842	2,871,664	0	0	48,490,000	17,127,600	47,440,000	18,267,200	151,017,842	42,497,073	193,514,915
2029	42,890,000	1,367,119	8,592,327	2,409,052	0	0	50,365,000	13,667,675	49,235,000	14,883,575	151,082,327	32,327,421	183,409,748
2030	0	0	9,066,623	1,921,557	0	0	71,345,000	9,407,825	70,155,000	10,704,925	150,566,623	22,034,307	172,600,930
2031	0	0	9,567,101	1,407,153	0	0	55,640,000	4,963,350	54,335,000	6,347,775	119,542,101	12,718,278	132,260,379
2032	0	0	10,095,205	865,121	0	0	26,435,000	2,090,725	24,990,000	3,571,400	61,520,205	6,527,246	68,047,451
2033	0	0	10,652,461	291,591	0	0	16,650,000	582,750	38,525,000	1,348,375	65,827,461	2,222,716	68,050,177
Total:	$685,315,000	$766,034,731	$160,763,445	$174,323,685	$500,000,000	$375,703,983	$715,000,000	$1,005,770,500	$717,030,000	$990,269,000	$2,778,108,445	$3,312,101,899	$6,090,210,344

(1) Excludes capitalized interest. Assumes Super Sinker Redemptions are made as scheduled.
(2) The year shown is the year in which Revenues are received and residuals are released to the Residual Certificate holder. Such Revenues are used to pay Debt Service in July of the year shown and January of the following year.
(3) Excludes $23,965,000 of Principal Installments already paid through Super Sinker Redemptions.
(4) Assumes the full amount of the TIFIA loan is drawn and includes an estimate for capitalized interest. To date, only $42,564,993.30 has been drawn. Estimates of principal and interest payments are based upon projected draws and were provided by TSASC as of April 5, 2002. Payments of interest on the TIFIA loan are calculated on an actual/actual basis at a rate of 5.52% per annum.

Debt Service Coverage

The following tables present schedules showing projected coverage of estimated Principal Installments Debt Service as well as Serial Maturities and Super Sinker Redemption Debt Service for: (i) the Series 1999-1 Bonds, the TIFIA Loan and the Series 2002-1 Bonds; and (ii) all Program Bonds including those series yet to be issued. The estimated debt service coverage ratios assume that cigarette consumption is consistent with the DRI•WEFA Base Case Forecast, Collections are received in accordance with the Cash Flow Assumptions, and interest rates for the Bonds are as described above under "Bond Structuring Assumptions." As used herein, "**Principal Installments Debt Service Coverage Ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period (including earnings on the Liquidity Reserve Account and other Pledged Accounts and earnings on Pledged TSRs until the applicable Distribution Date) and the denominator of which is the sum of TSASC's operating expenses and interest and Principal Installments required to be paid in such period. The Principal Installments Debt Service Coverage Ratios assume that no Super Sinker Redemptions are made in advance of the Mandatory Sinking Fund Installments and Term Bond Maturities. The Principal Installments Debt Service does not reflect the actual amortization of Bonds which will occur if the DRI•WEFA Base Case Forecast is realized. If actual Collections are received in the amounts assumed under the DRI•WEFA Base Case Forecast and the Cash Flow Assumptions, Surplus Collections would be applied to make Super Sinker Redemptions, as required pursuant to the Indenture. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION— Effect of Changes in Cigarette Consumption Levels on Super Sinker Redemptions" herein.

As used herein, "**Super Sinker Redemption Debt Service Coverage Ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Collections received in such period (including earnings on the Liquidity Reserve Account and other Pledged Accounts and earnings on Pledged TSRs until the applicable Distribution Date) and the denominator of which is the sum of TSASC's operating expenses, interest, Serial Maturities and Super Sinker Redemptions required to be paid in such period.

Principal Installments Debt Service Coverage of Outstanding Bonds and Series 2002-1 Bonds

Year(1)	Total Available Funds(2)	Principal Installments	Interest	Operating Expenses(3)	Debt Service and Operating Expenses(4)	Debt Service Coverage
2003	$256,235,030	$ 0	$61,649,321	$1,092,727	$ 62,742,048	4.08
2004	223,893,039	0	77,905,684	1,125,509	79,031,192	2.83
2005	226,864,746	0	78,730,300	1,159,274	79,889,574	2.84
2006	230,898,555	1,425,000	78,708,925	1,194,052	81,327,977	2.84
2007	234,705,449	1,420,000	78,663,410	1,229,874	81,313,284	2.89
2008	243,148,046	13,170,000	78,358,363	1,266,770	92,795,133	2.62
2009	246,763,375	15,080,000	77,740,151	1,304,773	94,124,924	2.62
2010	249,977,762	16,705,000	77,010,691	1,343,916	95,059,607	2.63
2011	253,466,980	15,105,000	76,218,531	1,384,234	92,707,765	2.73
2012	256,989,514	19,305,000	75,346,647	1,425,761	96,077,408	2.67
2013	260,293,367	16,685,000	74,415,932	1,468,534	92,569,466	2.81
2014	263,568,397	22,180,000	73,369,515	1,512,590	97,062,104	2.72
2015	266,719,536	18,870,000	72,252,775	1,557,967	92,680,743	2.88
2016	270,441,726	23,357,825	71,065,317	1,604,706	96,027,849	2.82
2017	274,153,655	27,564,005	69,630,773	1,652,848	98,847,625	2.77
2018	310,651,534	37,935,462	67,771,571	1,702,433	107,409,466	2.89
2019	314,692,178	40,672,763	65,527,026	1,753,506	107,953,295	2.92
2020	318,627,879	41,721,508	63,175,425	1,806,111	106,703,044	2.99
2021	322,944,883	44,612,327	60,697,902	1,860,295	107,170,524	3.01
2022	327,216,802	47,815,887	58,019,183	1,916,103	107,751,174	3.04
2023	331,670,457	50,182,892	55,166,714	1,973,587	107,323,193	3.09
2024	336,136,610	52,994,084	52,163,577	2,032,794	107,190,455	3.14
2025	340,974,405	54,675,245	48,997,139	2,093,778	105,766,162	3.22
2026	345,867,135	56,907,203	45,683,817	2,156,591	104,747,611	3.30
2027	350,858,995	60,820,828	42,186,106	2,221,289	105,228,223	3.33
2028	355,961,622	61,577,042	38,551,775	2,287,928	102,416,745	3.48
2029	361,173,677	63,731,815	34,833,967	2,356,566	100,922,347	3.58
2030	366,466,737	66,516,171	30,971,918	2,427,262	99,915,352	3.67
2031	371,858,794	70,286,192	26,915,799	2,500,080	99,702,071	3.73
2032	377,181,247	75,008,017	22,607,586	2,575,083	100,190,686	3.76
2033	382,420,237	41,217,852	19,125,069	2,652,335	62,995,257	6.07
2034	388,007,530	44,271,965	16,495,266	2,731,905	63,499,136	6.11
2035	393,587,165	47,276,698	13,655,903	2,813,862	63,746,463	6.17
2036	398,561,397	50,578,464	10,619,655	2,898,278	64,096,397	6.22
2037	404,168,070	49,613,755	7,511,945	2,985,227	60,110,927	6.72
2038	409,892,625	48,084,146	4,489,277	3,074,783	55,648,207	7.37
2039	415,828,254	48,711,299	1,500,423	3,167,027	53,378,749	7.79
2040	0	0	0	0	0	
2041	0	0	0	0	0	
2042	0	0	0	0	0	

Principal Installments Debt Service Coverage of All Program Bonds

Year(1)	Total Available Funds(2)	Principal Installments of All Program Bonds	Interest on All Program Bonds	Operating Expenses(3)	Total Debt Service and Operating Expenses(4)	Debt Service Coverage for All Program Bonds
2003	$257,510,653	$ 0	$ 61,649,321	$1,092,727	$ 62,742,048	4.10
2004	227,568,705	0	127,955,684	1,125,509	129,081,192	1.76
2005	231,664,959	0	178,972,400	1,159,274	180,131,674	1.29
2006	235,701,944	1,965,000	178,932,125	1,194,052	182,091,177	1.29
2007	239,537,066	6,850,000	178,677,660	1,229,874	186,757,534	1.28
2008	247,958,968	15,980,000	178,084,213	1,266,770	195,330,983	1.27
2009	251,577,499	18,900,000	177,233,951	1,304,773	197,438,724	1.27
2010	254,795,045	21,695,000	176,196,141	1,343,916	199,235,057	1.28
2011	258,306,216	24,655,000	174,895,081	1,384,234	200,934,315	1.29
2012	261,808,923	27,065,000	173,417,347	1,425,761	201,908,108	1.30
2013	265,124,446	27,715,000	171,828,982	1,468,534	201,012,516	1.32
2014	268,374,267	30,750,000	170,096,565	1,512,590	202,359,154	1.33
2015	271,530,935	29,800,000	168,297,325	1,557,967	199,655,293	1.36
2016	275,236,835	33,327,825	166,378,367	1,604,706	201,310,899	1.37
2017	278,928,232	35,694,005	164,310,323	1,652,848	201,657,175	1.38
2018	315,489,520	58,195,462	161,457,471	1,702,433	221,355,366	1.43
2019	319,516,428	61,952,763	157,759,026	1,753,506	221,465,295	1.44
2020	323,427,991	62,421,508	153,938,125	1,806,111	218,165,744	1.48
2021	327,730,595	66,292,327	149,977,302	1,860,295	218,129,924	1.50
2022	331,988,747	70,745,887	145,737,233	1,916,103	218,399,224	1.52
2023	336,426,301	74,172,892	141,242,564	1,973,587	217,389,043	1.55
2024	340,879,906	78,824,084	136,495,727	2,032,794	217,352,605	1.57
2025	345,711,300	83,695,245	131,409,539	2,093,778	217,198,562	1.59
2026	350,575,822	85,937,203	126,064,467	2,156,591	214,158,261	1.64
2027	355,547,226	91,180,828	120,488,106	2,221,289	213,890,223	1.66
2028	360,625,573	92,837,042	114,697,075	2,287,928	209,822,045	1.72
2029	365,810,061	95,481,815	108,773,917	2,356,566	206,612,297	1.77
2030	371,082,897	100,086,171	102,625,668	2,427,262	205,139,102	1.81
2031	376,450,018	105,176,192	96,173,449	2,500,080	203,849,721	1.85
2032	381,759,009	113,388,017	89,300,786	2,575,083	205,263,886	1.86
2033	387,198,649	120,077,852	81,714,869	2,652,335	204,445,057	1.89
2034	392,746,998	129,571,965	73,339,466	2,731,905	205,643,336	1.91
2035	398,272,537	137,506,698	64,356,553	2,813,862	204,677,113	1.95
2036	403,187,988	145,758,464	54,830,955	2,898,278	203,487,697	1.98
2037	408,728,943	149,383,755	44,899,995	2,985,227	197,268,977	2.07
2038	414,383,191	152,424,146	34,733,477	3,074,783	190,232,407	2.18
2039	420,189,434	148,331,299	24,606,023	3,167,027	176,104,349	2.39
2040	425,636,273	133,615,000	14,942,375	3,262,038	151,819,413	2.80
2041	431,109,034	94,600,000	6,954,850	3,359,899	104,914,749	4.11
2042	433,488,208	52,055,000	1,821,925	3,460,696	57,337,621	7.56

(1) The year shown is the year in which revenues are received and residual is released to the Residual Certificate Holder. Such revenues are used to pay debt service in July of the year shown and January of the following year.

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

(3) Includes Operating Expenses at the Operating Cap.

(4) Includes interest and Principal Installments on the Bonds as well as Operating Expenses at the Operating Cap. Amounts shown are net of capitalized interest.

Serial Maturities and Super Sinker Redemption Debt Service Coverage of Outstanding Bonds and Series 2002-1 Bonds

Year(1)	Total Available Funds(2)	Serial Maturities and Super Sinker Redemptions	Interest	Operating Expenses(3)	Debt Service and Operating Expenses(4)	Debt Service Coverage
2003	$256,491,005	$42,310,000	$60,507,083	$1,092,727	$103,909,810	2.47
2004	223,986,833	20,755,000	75,061,580	1,125,509	96,942,089	2.31
2005	226,906,015	14,646,334	74,932,201	1,159,274	90,737,809	2.50
2006	230,934,599	17,036,955	74,092,426	1,194,052	92,323,433	2.50
2007	234,730,669	17,204,787	73,190,966	1,229,874	91,625,627	2.56
2008	243,142,724	25,950,228	72,087,326	1,266,770	99,304,324	2.45
2009	246,749,083	28,113,696	70,715,146	1,304,773	100,133,615	2.46
2010	249,958,328	30,695,636	69,179,179	1,343,916	101,218,731	2.47
2011	253,438,967	29,626,515	67,528,233	1,384,234	98,538,981	2.57
2012	256,958,183	35,306,827	65,735,491	1,425,761	102,468,078	2.51
2013	260,256,843	34,052,092	63,803,269	1,468,534	99,323,895	2.62
2014	263,524,502	40,702,859	61,692,252	1,512,590	103,907,701	2.54
2015	266,686,866	41,854,709	59,336,657	1,557,967	102,749,334	2.60
2016	270,382,179	45,083,253	56,797,349	1,604,706	103,485,309	2.61
2017	274,086,888	51,154,137	53,988,333	1,652,848	106,795,318	2.57
2018	310,587,046	65,258,041	50,579,659	1,702,433	117,540,133	2.64
2019	314,614,161	69,735,685	46,579,756	1,753,506	118,068,947	2.66
2020	318,551,427	75,327,827	42,248,237	1,806,111	119,382,175	2.67
2021	322,844,880	79,175,267	37,635,050	1,860,295	118,670,611	2.72
2022	327,091,652	83,148,849	32,790,199	1,916,103	117,855,151	2.78
2023	331,520,644	86,469,466	27,727,565	1,973,587	116,170,618	2.85
2024	335,953,570	88,943,056	22,490,638	2,032,794	113,466,488	2.96
2025	340,643,074	71,125,613	17,657,243	2,093,778	90,876,634	3.75
2026	345,395,513	52,583,183	13,835,815	2,156,591	68,575,589	5.04
2027	350,372,873	53,866,871	10,506,882	2,221,289	66,595,042	5.26
2028	355,481,694	55,087,842	7,102,273	2,287,928	64,478,043	5.51
2029	360,662,303	51,482,327	3,776,171	2,356,566	57,615,063	6.26
2030	365,694,420	9,066,623	1,921,557	2,427,262	13,415,443	27.26
2031	371,114,821	9,567,101	1,407,153	2,500,080	13,474,334	27.54
2032	376,462,880	10,095,205	865,121	2,575,083	13,535,409	27.81
2033	381,962,579	10,652,461	291,591	2,652,335	13,596,388	28.09

Serial Maturities and Super Sinker Redemption Debt Service Coverage of All Program Bonds

Year(1)	Total Available Funds(2)	Serial Maturities and Super Sinker Redemptions	Interest on All Program Bonds	Operating Expenses(3)	Total Debt Service and Operating Expenses(4)	Debt Service Coverage for All Program Bonds
2003	$257,766,628	$ 42,310,000	$ 60,507,083	$1,092,727	$103,909,810	2.48
2004	227,795,510	43,375,000	124,319,880	1,125,509	168,820,389	1.35
2005	231,741,823	24,446,334	173,247,901	1,159,274	198,853,509	1.17
2006	235,762,861	27,176,955	171,710,226	1,194,052	200,081,233	1.18
2007	239,563,166	29,744,787	170,014,966	1,229,874	200,989,627	1.19
2008	247,950,393	36,345,228	168,108,601	1,266,770	205,720,599	1.21
2009	251,554,683	39,878,696	165,960,821	1,304,773	207,144,290	1.21
2010	254,763,229	44,290,636	163,537,254	1,343,916	209,171,806	1.22
2011	258,260,704	48,336,515	160,755,633	1,384,234	210,476,381	1.23
2012	261,753,287	52,586,827	157,703,241	1,425,761	211,715,828	1.24
2013	265,068,750	57,052,092	154,361,219	1,468,534	212,881,845	1.25
2014	268,301,982	61,657,859	150,711,777	1,512,590	213,882,226	1.25
2015	271,463,692	66,169,709	146,771,732	1,557,967	214,499,409	1.27
2016	275,142,172	70,563,253	142,489,599	1,604,706	214,657,559	1.28
2017	278,823,327	76,849,137	137,889,458	1,652,848	216,391,443	1.29
2018	315,401,038	108,398,041	132,071,559	1,702,433	242,172,033	1.30
2019	319,402,098	115,590,685	124,956,831	1,753,506	242,301,022	1.32
2020	323,314,810	124,602,827	117,295,762	1,806,111	243,704,700	1.33
2021	327,580,465	131,885,267	109,113,100	1,860,295	242,858,661	1.35
2022	331,795,007	139,108,849	100,464,799	1,916,103	241,489,751	1.37
2023	336,177,518	143,794,466	91,437,190	1,973,587	237,205,243	1.42
2024	340,546,875	144,953,056	82,233,538	2,032,794	229,219,388	1.49
2025	345,306,102	148,270,613	72,739,718	2,093,778	223,104,109	1.55
2026	350,111,030	151,433,183	62,758,465	2,156,591	216,348,239	1.62
2027	354,974,554	149,731,871	52,614,507	2,221,289	204,567,667	1.74
2028	359,990,381	151,017,842	42,497,073	2,287,928	195,802,843	1.84
2029	365,099,131	151,082,327	32,327,421	2,356,566	185,766,313	1.97
2030	370,280,617	150,566,623	22,034,307	2,427,262	175,028,193	2.12
2031	375,377,816	119,542,101	12,718,278	2,500,080	134,760,459	2.79
2032	380,274,465	61,520,205	6,527,246	2,575,083	70,622,534	5.38
2033	385,746,125	65,827,461	2,222,716	2,652,335	70,702,513	5.46

(1) The year shown is the year in which revenues are received and residual is released to the Residual Certificate Holder. Such revenues are used to pay debt service in July of the year shown and January of the following year.

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

(3) Includes Operating Expenses at the Operating Cap.

(4) Includes interest, Serial Maturities and Super Sinker Redemptions on the Bonds as well as Operating Expenses at the Operating Cap. Amounts shown are net of capitalized interest.

Allocation of Principal Payments

Due to a number of factors, including the actual consumption of cigarettes in the United States, the amount of available Collections may fluctuate from year to year. Unless an Event of Default has occurred, Collections available to make principal payments on Senior Bonds on any Distribution Date will be allocated to Serial Maturities, Mandatory Sinking Fund Installments and Super Sinker Term Bond Maturities due prior to allocations to Super Sinker Redemptions. Collections available to make Super Sinker Redemptions on Senior Bonds will be applied in ascending order of maturity and will be credited against Mandatory Sinking Fund Installments, for any particular Super Sinker Term Bond, in ascending order of Mandatory Sinking Fund Installment payment dates. Serial Maturities are not subject to Super Sinker Redemptions.

Failure to pay a Serial Maturity, Mandatory Sinking Fund Installment or Super Sinker Term Bond Maturity prior to its due date shall constitute an Event of Default. The ratings assigned to the Senior Bonds by each Rating Agency address such Rating Agency's assessment of the ability of TSASC to pay interest when due and pay Serial Maturities, Mandatory Sinking Fund Installments and Super Sinker Term Bond Maturities by their due dates with respect to the outstanding Bonds and the Series 2002-1 Bonds. Failure to meet the schedule of Super Sinker Redemptions will not constitute an Event of Default, nor do any ratings on the Senior Bonds address the payment of Super Sinker Redemptions.

The allocation of Collections according to Super Sinker Redemptions then due and then, for any Series of Senior Bonds, in order of Principal Installments, may result in the later Principal Installments of one Series being paid prior to the earlier Principal Installments of the same or another Series.

Effect of Changes in Cigarette Consumption Levels

Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in cigarette consumption on the weighted average lives and final principal payments of the Series 2002-1 Super Sinker Term 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 DRI•WEFA Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of DRI•WEFA (the DRI•WEFA High Forecast, the DRI•WEFA Low Case 1, the DRI•WEFA Low Case 2 and the DRI•WEFA Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by DRI•WEFA (assuming 3.5% and 4.0% annual consumption declines). In each scenario, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Cash Flow Assumptions, the final principal payments and weighted average lives (in years) of each of the Term 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 principal payment dates) for the Super Sinker Term Bonds will be either shorter (sooner) or longer (later) than projected below.

Series 2002-1 Super Sinker Term Bonds Maturing July 15, 2024

Consumption Forecast	Weighted Average Life (Years)*	Final Principal Payment Date*
DRI•WEFA Base Case Forecast	9.2	15-Jul-2018
DRI•WEFA High Forecast	9.2	15-Jul-2018
DRI•WEFA Low Case 1	9.2	15-Jul-2018
DRI•WEFA Low Case 2	9.2	15-Jul-2018
DRI•WEFA Low Case 3	9.3	15-Jul-2018
3.5% Annual Consumption Decline	9.2	15-Jul-2018
4.0% Annual Consumption Decline	9.5	15-Jul-2019

Series 2002-1 Super Sinker Term Bonds Maturing July 15, 2032

Consumption Forecast	Weighted Average Life (Years)*	Final Principal Payment Date*
DRI•WEFA Base Case Forecast	19.7	15-Jul-2025
DRI•WEFA High Forecast	19.7	15-Jul-2025
DRI•WEFA Low Case 1	19.7	15-Jul-2025
DRI•WEFA Low Case 2	19.7	15-Jul-2025
DRI•WEFA Low Case 3	19.7	15-Jul-2025
3.5% Annual Consumption Decline	19.8	15-Jul-2025
4.0% Annual Consumption Decline	20.9	15-Jul-2027

* Reflects effects of changes in consumption on the Series 2002-1 Super Sinker Term Bonds in the context of the full $2.8 billion issuance program.

Super Sinker Redemptions. The tables below have been prepared to show the effect of changes in cigarette consumption on the projected outstanding amounts of the Super Sinker Term Bonds. The tables are based upon the same assumptions and utilize the same alternative DRI•WEFA forecasts as shown in the preceding paragraph and tables.

Projected Outstanding Principal Balances for Series 2002-1 Super Sinker Term Bonds Maturing July 15, 2024*

Date	DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement . .	$190,710,000	$190,710,000	$190,710,000	$190,710,000	$190,710,000	$190,710,000	$190,710,000
15-Jul-2003 . .	156,915,000	156,915,000	156,915,000	156,915,000	156,915,000	156,915,000	156,915,000
15-Jul-2004 . .	142,680,000	142,680,000	142,680,000	142,680,000	142,680,000	142,680,000	142,680,000
15-Jul-2005 . .	137,745,000	137,745,000	137,745,000	137,745,000	138,175,000	137,745,000	137,745,000
15-Jul-2006 . .	132,690,000	132,690,000	132,690,000	132,690,000	133,010,000	132,690,000	132,690,000
15-Jul-2007 . .	128,310,000	128,310,000	128,310,000	128,310,000	128,340,000	128,310,000	128,310,000
15-Jul-2008 . .	123,420,000	123,420,000	123,420,000	123,420,000	123,420,000	123,420,000	123,420,000
15-Jul-2009 . .	118,315,000	118,315,000	118,315,000	118,315,000	118,315,000	118,315,000	118,315,000
15-Jul-2010 . .	112,890,000	112,890,000	112,890,000	112,890,000	112,890,000	112,890,000	112,890,000
15-Jul-2011 . .	107,325,000	107,325,000	107,325,000	107,325,000	107,325,000	107,325,000	107,325,000
15-Jul-2012 . .	101,395,000	101,395,000	101,395,000	101,395,000	101,395,000	101,395,000	101,845,000
15-Jul-2013 . .	94,755,000	94,755,000	94,755,000	94,755,000	94,755,000	94,755,000	95,970,000
15-Jul-2014 . .	87,640,000	87,640,000	87,640,000	87,640,000	87,640,000	87,640,000	89,995,000
15-Jul-2015 . .	68,695,000	68,695,000	68,695,000	68,695,000	74,780,000	68,695,000	80,750,000
15-Jul-2016 . .	48,480,000	48,480,000	48,480,000	48,480,000	51,690,000	48,480,000	64,035,000
15-Jul-2017 . .	24,235,000	24,235,000	24,235,000	24,235,000	24,235,000	24,350,000	39,765,000
15-Jul-2018 . .	0	0	0	0	0	0	7,150,000
15-Jul-2019 . .	0	0	0	0	0	0	0
15-Jul-2020 . .	0	0	0	0	0	0	0
15-Jul-2021 . .	0	0	0	0	0	0	0
15-Jul-2022 . .	0	0	0	0	0	0	0
15-Jul-2023 . .	0	0	0	0	0	0	0
15-Jul-2024 . .	0	0	0	0	0	0	0
Average Life:	9.2	9.2	9.2	9.2	9.3	9.2	9.5

* Reflects effect of changes in consumption on the Series 2002-1 Super Sinker Term Bonds in the context of the full $2.8 billion issuance program. Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Super Sinker Redemptions on the referenced date.

Projected Outstanding Principal Balances for Series 2002-1 Super Sinker Term Bonds Maturing July 15, 2032*

Date	DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3	3.5% Annual Consumption Decline	4.0% Annual Consumption Decline
Settlement . .	$243,860,000	$243,860,000	$243,860,000	$243,860,000	$243,860,000	$243,860,000	$243,860,000
15-Jul-2003 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2004 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2005 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2006 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2007 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2008 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2009 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2010 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2011 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2012 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2013 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2014 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2015 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2016 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2017 . .	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000	243,860,000
15-Jul-2018 . .	238,405,000	238,405,000	238,405,000	238,405,000	238,405,000	238,840,000	243,860,000
15-Jul-2019 . .	207,005,000	207,005,000	207,005,000	207,005,000	207,005,000	208,230,000	221,465,000
15-Jul-2020 . .	172,920,000	172,920,000	172,920,000	172,920,000	172,920,000	176,020,000	196,375,000
15-Jul-2021 . .	136,700,000	136,700,000	136,700,000	136,700,000	136,700,000	141,395,000	171,695,000
15-Jul-2022 . .	98,555,000	98,555,000	98,555,000	98,555,000	98,555,000	103,970,000	143,930,000
15-Jul-2023 . .	59,195,000	59,195,000	59,195,000	59,195,000	59,195,000	64,065,000	112,500,000
15-Jul-2024 . .	19,515,000	19,515,000	19,515,000	19,515,000	19,515,000	22,970,000	78,290,000
15-Jul-2025 . .	0	0	0	0	0	0	42,640,000
15-Jul-2026 . .	0	0	0	0	0	0	14,280,000
15-Jul-2027 . .	0	0	0	0	0	0	0
15-Jul-2028 . .	0	0	0	0	0	0	0
15-Jul-2029 . .	0	0	0	0	0	0	0
15-Jul-2030 . .	0	0	0	0	0	0	0
15-Jul-2031 . .	0	0	0	0	0	0	0
15-Jul-2032 . .	0	0	0	0	0	0	0
Average Life:	19.7	19.7	19.7	19.7	19.7	19.8	20.9

* Reflects effect of changes in consumption on the Series 2002-1 Super Sinker Term Bonds in the context of the full $2.8 billion issuance program. Outstanding amounts represent principal balances after application of Collections to Sinking Fund Installments and Super Sinker Redemptions on the referenced date.

The table below has been prepared to show the effect of changes in cigarette consumption on the projected weighted average lives and final principal payment dates of the Series 1999-1 and Series 2002-1 Bonds.

	Series 1999-1		Series 2002-1	
Consumption Forecast	Weighted Average Life*	Final Principal Payment*	Weighted Average Life*	Final Principal Payment*
DRI•WEFA Base Case	20.3	15-Jul-2029	14.3	15-Jul-2025
DRI•WEFA High Forecast	20.3	15-Jul-2029	14.3	15-Jul-2025
DRI•WEFA Low Case 1	20.3	15-Jul-2029	14.3	15-Jul-2025
DRI•WEFA Low Case 2	20.3	15-Jul-2029	14.3	15-Jul-2025
DRI•WEFA Low Case 3	20.3	15-Jul-2029	14.3	15-Jul-2025
3.5% Annual Decline	20.4	15-Jul-2029	14.4	15-Jul-2025
4.0% Annual Decline	21.8	15-Jul-2034	15.0	15-Jul-2027

* Reflects effect of changes in consumption on the Series 1999-1 and Series 2002-1 Super Sinker Term Bonds in the context of the full $2.8 billion issuance program. Average lives for the Series 1999-1 Bonds are measured from their date of original issuance taking into account Super Sinker Redemptions to date.

Explanation of Alternative DRI•WEFA Forecasts. The alternative DRI•WEFA forecasts of cigarette consumption decline, used in the analysis above, are based upon the assumptions described below. See also "DRI•WEFA REPORT" herein and Appendix A hereto.

DRI•WEFA's high forecast of consumption (the "**DRI•WEFA 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 DRI•WEFA Base Case Forecast. Under the DRI•WEFA High Forecast, the average annual rate of decline in cigarette consumption is reduced slightly, from an average annual rate in the Base Case Forecast of 1.69%, to 1.53%, resulting in consumption of 225 billion in 2042.

DRI•WEFA's low forecast of consumption (the "**DRI•WEFA Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The DRI•WEFA Base Case Forecast applies a price elasticity of demand of -0.31. However, in order to develop the lowest consumption forecast that DRI•WEFA believes may be reasonably anticipated, a price elasticity of -0.4 is applied. Under the DRI•WEFA 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 1.69%, to 1.90%, resulting in consumption of 192 billion in 2042.

Although beyond the range of DRI•WEFA's reasonably anticipated decline in consumption, DRI•WEFA also prepared an alternative low case (the "**DRI•WEFA 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 2.12% to 175 billion in 2042. DRI•WEFA prepared another alternative low case (the "**DRI•WEFA Low Case 3**") that deviates from the Base Case Forecast by assuming an adverse federal government settlement or tort claims of three times the size of the MSA, resulting in an immediate real price increase of 57% and a decline of 17.7% in consumption over two years. Under the DRI•WEFA Low Case 3, the average annual rate of decline in cigarette consumption is increased from an average annual rate in the Base Case Forecast of 1.69%, to 2.10%, resulting in consumption of 176 billion in 2042.

Average Annual Rate of Cigarette Consumption Decline (2001-2042)

DRI•WEFA Base Case Forecast	DRI•WEFA High Forecast	DRI•WEFA Low Case 1	DRI•WEFA Low Case 2	DRI•WEFA Low Case 3
1.69%	**1.53%**	**1.90%**	**2.12%**	**2.10%**

Finally, for comparative purposes DRI•WEFA calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4.0%. DRI•WEFA states that at 3.5% per year consumption falls to 96 billion by 2042, and at 4.0% it falls to 77 billion.

No assurance can be given that actual cigarette consumption in the United States during the term of the 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 Collections available to make Super Sinker Redemptions will be affected and the resulting weighted average lives and final principal payment dates of the Super Sinker Term Bonds will vary. See "RISK FACTORS" herein.

PLAN OF FINANCE

The Series 2002-1 Bonds are Program Bonds which are a Series of parity Senior Bonds of TSASC, and will be issued pursuant to the Indenture and the Series 2002-1 Supplement. The first Series of Senior Bonds, the Series 1999-1 Bonds, were issued in an aggregate principal amount of $709,280,000 on November 18, 1999 of which $685,315,000 remain outstanding. Pursuant to the TIFIA Loan Agreement, TSASC issued Senior Bonds in the amount of approximately $42.6 million, and has the ability to issue an additional approximately $116.6 million of Senior Bonds, plus capitalized interest. See "THE INDENTURE—TIFIA Loan Agreement".

Under the Indenture, TSASC may issue up to an aggregate principal amount of approximately $2.8 billion of Program Bonds, depending on actual Debt Service at the time of issuance. Each Series of Senior Bonds (including any Program Bonds) is and will be on a parity with each other Series of Senior Bonds. Senior Bonds may be issued with Rating Confirmation, and Program Bonds may be issued without Rating Confirmation if certain financial tests are met. In addition, TSASC may also issue BANs and Subordinate Bonds, with Rating Confirmation and subject to the provisions of the Indenture.

Upon the sale of the Series 2002-1 Bonds, TSASC will pay the net proceeds of the sale of the Series 2002-1 Bonds to the Trust for transfer to the City. The assets of the Trust consist primarily of the Residual Certificate which entitles the Trust to the net proceeds of TSASC's Bonds issued subsequent to the Series 1999-1 Bonds (other than refunding Bonds), and to TSRs received by TSASC that are not required to fund various expenses, debt service or required reserves with respect to the Bonds. The City owns the sole beneficial interest in the Trust.

The City will use the net proceeds of the Series 2002-1 Bonds to pay, or reimburse itself for the payment of, the costs of certain capital projects of the City and certain costs relating to the closing of the Freshkills Landfill.

The term "Principal Installments" includes "Rated Maturities", and the term "Super Sinker Redemptions" includes "Planned Principal Payments", when used in respect of prior issuances of Senior Bonds, or in respect of terms that include such prior issuances, such as "all Senior Bonds" and "all Program Bonds".

TSASC, INC.

TSASC is a special purpose, bankruptcy-remote local development corporation incorporated under the provisions of Section 1411 of the New York State Not-For-Profit Corporation Law. TSASC is a non-stock, membership corporation governed by a board of directors. TSASC is operated exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Code. The board of directors of TSASC will have not less than five nor more than seven directors, a majority of whom will be officials of the City. The names of TSASC's current directors and officers, and their principal occupations and offices, are set out below. The Certificate of Incorporation of TSASC contains the standard limitation of purposes and corporate separateness criteria to permit Transaction Counsel to opine that TSASC would not be substantively consolidated with the City in the event the City were to become a debtor under the Bankruptcy Code. See "LEGAL CONSIDERATIONS" herein. Such criteria include a requirement that, prior to the first meeting at which their vote on certain issues may be required, there will be two directors independent of the City whose consent is required for, among other things, any bankruptcy filing by TSASC. TSASC has no assets other than the Collections and the Reserves.

The directors of TSASC are:

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

The officers of TSASC are:

Name	Office
Mark Page	President
Alan L. Anders	Vice President and Treasurer
Marjorie E. Henning	Vice President and Secretary
Prescott D. Ulrey	Assistant Secretary
Wei-Li Pai	Assistant Treasurer
Lawrence R. Glantz	Comptroller

Mark Page, President

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

Alan L. Anders, Vice President and Treasurer

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

Marjorie E. Henning, Vice President and Secretary

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

Prescott D. Ulrey, Assistant Secretary

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

Wei-Li Pai, Assistant Treasurer

Ms. Pai was appointed Assistant Treasurer in November 1999. She is a graduate of Rutgers University and the London School of Economics. She also serves as Director of Financing Strategies and Quantitative Analysis of the Office of Management and Budget of the City.

Lawrence R. Glantz, Comptroller

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

THE TRUST AND THE RESIDUAL CERTIFICATE

The Trust has been organized as a Delaware business trust, and is administered by Wilmington Trust Company, as trustee. The Residual Certificate was deposited by TSASC into the Trust, and the beneficial ownership of the Trust was transferred by TSASC to the City as part of the purchase price of the TSRs. The organizational and operative documents of the Trust provide for the distribution to the beneficial owner of the Trust of cash available to the Trust from payments made on the Residual Certificate after payment of the expenses of the Trust.

The Residual Certificate represents the entitlement to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate. Payments on the Residual Certificate from Collections are subordinate to payments on the Bonds. Delaware law expressly provides that no creditor of the beneficial owner of a Delaware business trust shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of such business trust.

THE SERIES 2002-1 BONDS

The following summary describes certain terms of the Series 2002-1 Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture, the Series 2002-1 Supplement and the Series 2002-1 Bonds. Copies of the Indenture and the Series 2002-1 Supplement may be obtained upon written request to the Indenture Trustee.

The Series 2002-1 Bonds will initially be represented by one or more bond certificates 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 2002-1 Bonds. The Series 2002-1 Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof in book-entry form only. Except under the limited circumstances described herein, no Beneficial Owner of Series 2002-1 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2002-1 Bonds. See "THE SERIES 2002-1 BONDS—Book–Entry Only System."

Payments of Interest

Interest on the principal balance of the Series 2002-1 Bonds will be payable on each January 15 and July 15, commencing January 15, 2003. Interest will accrue from and including the Closing Date, or from and including the most recent Distribution Date on which interest has been paid, to but excluding the following Distribution Date. Interest on the Series 2002-1 Bonds will be computed on the basis of a 360-day year. Interest on the Series 2002-1 Bonds through July 15, 2003 will be funded from proceeds of the Series 2002-1 Bonds.

If on any Distribution Date there are insufficient funds to pay all interest then due on the Series 2002-1 Bonds, available amounts will be allocated pro rata among all Series 2002-1 Bonds, and all other outstanding Senior Bonds, based on the respective amounts of interest due thereon.

For each Distribution Date, payments will be made to holders of Series 2002-1 Bonds of record (the "**Bondholders**") as of the Record Date.

"**Record Date**" means the last Business Day of the month preceding a Distribution Date, or such other date as may be specified by the Indenture or an officer's certificate of TSASC, and each of TSASC or the Indenture Trustee may in its discretion establish special record dates for the determination of the holders of Bonds for various purposes thereof, including giving consent or direction to the Indenture Trustee.

"**Business Day**" means any day other than (i) a Saturday or a Sunday or (ii) a day on which banking institutions in New York, New York are required or authorized by law to be closed.

Payments of Principal

The Series 2002-1 Bonds will consist of (i) Fixed Amortization Serial Bonds ("**Fixed Amortization Serial Bonds**") and (ii) Super Sinker Term Bonds ("**Super Sinker Term Bonds**").

Scheduled principal payments on the Series 2002-1 Bonds will consist of either Principal Installments or Super Sinker Redemptions.*

"**Principal Installments**" will consist of (i) principal payments on the stated maturity dates of the Fixed Amortization Serial Bonds ("**Serial Maturities**"), (ii) mandatory sinking fund installment payments on the Super Sinker Term Bonds ("**Mandatory Sinking Fund Installments**") and (iii) principal payments on the stated maturity date of the Super Sinker Term Bonds ("**Super Sinker Term Bond Maturities**"). The Distribution Date on which a Principal Installment is scheduled to be paid in respect of a Series 2002-1 Bond or other Program Bond is referred to herein as a "**Principal Installment Payment Date**".

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* The term "Principal Installments" includes "Rated Maturities", and the term "Super Sinker Redemptions" includes "Planned Principal Payments", when used in respect of prior issuances of Senior Bonds, or in respect of terms that include such prior issuances, such as "all Senior Bonds" and "all Program Bonds".

Principal Installments represent the amount of principal that TSASC will pay on the Senior Bonds as of the specified Principal Installment Payment Dates from Collections and, if necessary, from Reserves, including the Liquidity Reserve Account. A failure by TSASC to pay all or a portion of any Principal Installment on the relevant Principal Installment Payment Date, taking into account all payments of principal made on or prior to such Principal Installment Payment Date in respect of the applicable Senior Bond (including Super Sinker Redemptions), will constitute an Event of Default under the Indenture and could result in the Extraordinary Prepayment of the Senior Bonds, including the Series 2002-1 Bonds, on a semiannual basis in order of their maturity as described herein. **The ratings of the Series 2002-1 Bonds address the ability of TSASC to pay interest and Principal Installments when due.**

"**Super Sinker Redemptions**" represent the amount of principal TSASC has covenanted to pay on certain of the Senior Bonds, including the Super Sinker Term Bonds, to the extent of available Collections, as of specified Distribution Dates (each, a "**Super Sinker Redemption Date**"). Super Sinker Redemptions will not be made from the Liquidity Reserve Account. To the extent that Super Sinker Redemptions are paid, such payments will be credited against Principal Installments on the applicable Senior Bonds according to the schedule of Super Sinker Redemptions set forth below. Failure to make Super Sinker Redemptions will not constitute an Event of Default. However, no payments will be made to the City with respect to the Residual Certificate and no additional Senior Bonds may be issued unless and until TSASC is current in respect of all Super Sinker Redemptions. If TSASC is unable to make a Super Sinker Redemption on a given Super Sinker Redemption Date, principal could be paid in respect of Super Sinker Redemptions, to the extent of available Collections, as frequently as semiannually on subsequent Distribution Dates, until TSASC is current in respect of all Super Sinker Redemptions. **The ratings of the Series 2002-1 Bonds do not address TSASC's ability to make Super Sinker Redemptions.**

Mandatory Sinking Fund Installments and Super Sinker Redemptions

The Super Sinker Term Bonds maturing on July 15, 2024 are subject to mandatory redemption from Mandatory Sinking Fund Installments in the amounts and on the dates set forth below at a redemption price of par plus accrued interest to the date fixed for redemption. To the extent of available Collections, the Super Sinker Term Bonds maturing on July 15, 2024 are further subject to Super Sinker Redemptions in the amounts and on the dates set forth below at a redemption price of par plus accrued interest to the date fixed for redemption. Any Super Sinker Redemptions so paid will be credited against Mandatory Sinking Fund Installments in ascending order of maturity.

$190,710,000 Super Sinker Term Bonds
Maturing July 15, 2024

Date (July 15)	Mandatory Sinking Fund Installments and Super Sinker Term Bond Maturity	Super Sinker Redemptions
2003		$33,795,000
2004		14,235,000
2005		4,935,000
2006		5,055,000
2007		4,380,000
2008		4,890,000
2009		5,105,000
2010		5,425,000
2011		5,565,000
2012		5,930,000
2013		6,640,000
2014		7,115,000
2015	$11,480,000	18,945,000
2016	11,925,000	20,215,000
2017	14,960,000	24,245,000
2018	18,540,000	24,235,000
2019	19,550,000	
2020	20,615,000	
2021	21,740,000	
2022	22,845,000	
2023	23,855,000	
2024	25,200,000	

At the option of TSASC, there shall be applied to or credited against any of the required amounts in respect of the Super Sinker Term Bonds maturing July 15, 2024 the principal amount of any such Super Sinker Term Bonds that have been defeased, purchased or redeemed and not previously so applied or credited.

The Super Sinker Term Bonds maturing on July 15, 2032 are subject to mandatory redemption from Mandatory Sinking Fund Installments in the amounts and on the dates set forth below at a redemption price of par plus accrued interest to the date fixed for redemption. To the extent of available Collections, the Super Sinker Term Bonds maturing on July 15, 2032 are further subject to Super Sinker Redemptions in the amounts and on the dates set forth below at a redemption price of par plus accrued interest to the date fixed for redemption. Any Super Sinker Redemptions so paid will be credited against Mandatory Sinking Fund Installments in ascending order of maturity.

$243,860,000 Super Sinker Term Bonds
Maturing July 15, 2032

Date (July 15)	Mandatory Sinking Fund Installment and Super Sinker Term Bond Maturity	Super Sinker Redemption
2018		$ 5,455,000
2019		31,400,000
2020		34,085,000
2021		36,220,000
2022		38,145,000
2023		39,360,000
2024		39,680,000
2025	$26,120,000	19,515,000
2026	26,945,000	
2027	28,280,000	
2028	29,520,000	
2029	30,660,000	
2030	32,305,000	
2031	33,840,000	
2032	36,190,000	

At the option of TSASC, there shall be applied to or credited against any of the required amounts in respect of the Super Sinker Term Bonds maturing July 15, 2032 the principal amount of any such Super Sinker Term Bonds that have been defeased or redeemed and not previously so applied or credited. TSASC has agreed not to make open market purchases or tenders of the Super Sinker Term Bonds maturing July 15, 2032.

Extraordinary Prepayment

If an Event of Default has occurred, on each Distribution Date outstanding Senior Bonds will be prepaid, in whole or in part, in an amount equal to the available funds on deposit in the Extraordinary Prepayment Account and the Trapping Account, without premium (any such prepayment of a Senior Bond prior to the relevant Super Sinker Redemption Date, or Principal Installment Payment Date with respect to those Senior Bonds which are not subject to Super Sinker Redemptions, an "**Extraordinary Prepayment**"). Collections are only deposited in the Extraordinary Prepayment Account to the extent all current and past due interest on Senior Bonds has been paid and all Principal Installments and Super Sinker Redemptions then due have been paid.

Optional Redemption

The Series 2002-1 Bonds maturing on or before July 15, 2012 are not subject to redemption at TSASC's option prior to their respective Principal Installment Payment Dates. The Series 2002-1 Bonds maturing on or after July 15, 2013 are subject to redemption at TSASC's option at any time on or after July 15, 2012, in whole or in part, at a redemption price of 100% of the principal amount thereof.

All Series 2002-1 Bonds are subject to redemption without premium from sources other than Collections on or after their respective Super Sinker Redemption Dates or Principal Installment Payment Dates. TSASC may select dates, amounts, interest rates and maturities of Senior Bonds for optional redemption at its sole discretion. Thirty days' notice shall be given to holders of Series 2002-1 Bonds to be redeemed prior to maturity. On and after any date of redemption, interest will cease to accrue on any Series 2002-1 Bonds called for redemption.

Additional Series of Bonds

TSASC may authorize, issue, sell and deliver Bonds from time to time in such principal amounts as TSASC may determine; and may issue Bonds to renew or refund Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine. Subsequent to the issuance of the Series 2002-1 Bonds, additional Bonds may be issued:

(1) as Senior Bonds (a) with Rating Confirmation; or (b) without Rating Confirmation (x) if (i) annual Debt Service, separately calculated using Principal Installments and Super Sinker Redemptions, will not exceed the Annual Program Debt Service as set forth below under the caption "Annual Program Debt Service Schedules"; (ii) Super Sinker Redemptions are current prior to the receipt of the proceeds of the Bonds to be issued; (iii) the Liquidity Reserve Account and the Trapping Account will be at least at their respective requirements; and (iv) no Event of Default has occurred; or (y) to refund Senior Bonds if annual Debt Service, separately calculated using Principal Installments and Super Sinker Redemptions, will not increase in any year in which other Series of Senior Bonds are outstanding.

(2) as BANs (a) with Rating Confirmation; or (b) subject to (i) authorization of a Series of Program Bonds in anticipation of which the BANs are to be issued; and (ii) satisfaction of the conditions in clause (1)(b) above with respect to such BANs, and of such condition (i) with respect to such authorized but unissued Series of Program Bonds based upon assumed Debt Service deemed reasonable by TSASC, or (c) to renew BANs; or

(3) as Subordinate Bonds, with Rating Confirmation.

Interest on BANs may be payable from the Bond Fund on a parity with, or junior to, payments of interest on Senior Bonds or from Bond proceeds or such other sources as may be specified by Series Supplement. Principal of BANs may be payable from Bond proceeds and such other sources (but neither the Collection Account nor the Bond Fund) as may be specified by Series Supplement.

Annual Program Debt Service Schedule

It is a precondition to the issuance of additional Program Bonds that the annual Debt Service on all outstanding Senior Bonds after giving effect to the proposed issuance and calculated separately using Principal Installments and Super Sinker Redemptions, not exceed the following amounts in the following Fiscal Years:

TSASC Fiscal Year Ended July 1*	Principal Installment Annual Debt Service	Super Sinker Redemption Annual Debt Service	TSASC Fiscal Year Ended July 1*	Principal Installment Annual Debt Service	Super Sinker Redemption Annual Debt Service
2003	$127,309,601	$171,277,463	2024	$219,200,913	$235,239,700
2004	183,679,364	214,441,753	2025	219,115,031	227,194,225
2005	190,516,864	195,421,836	2026	218,898,138	221,015,556
2006	190,962,796	197,700,939	2027	215,799,069	214,193,725
2007	192,769,909	198,895,420	2028	215,464,994	202,352,988
2008	193,807,618	199,770,005	2029	211,341,019	193,521,884
2009	198,369,318	204,457,613	2030	208,063,819	183,416,469
2010	199,854,046	205,846,351	2031	206,518,113	172,606,300
2011	201,614,068	207,838,187	2032	205,158,725	132,264,925
2012	203,272,976	209,098,844	2033	206,499,219	68,056,425
2013	204,207,580	210,298,994	2034	205,607,544	N.L.
2014	203,389,065	211,424,069	2035	206,727,844	N.L.
2015	204,647,448	212,375,169	2036	205,682,266	N.L.
2016	201,865,058	212,954,719	2037	204,417,488	N.L.
2017	203,479,361	213,063,450	2038	198,110,944	N.L.
2018	203,773,471	214,746,956	2039	190,987,953	N.L.
2019	223,427,894	240,479,594	2040	176,771,047	N.L.
2020	223,493,319	240,557,588	2041	152,369,025	N.L.
2021	220,139,069	241,910,538	2042	105,291,375	N.L.
2022	220,050,794	241,003,250	2043	57,628,800	N.L.
2023	220,270,275	239,580,488			

* Comprised of Debt Service payments due on July 15 and January 15 of the TSASC Fiscal Year ending on June 30 of the year shown.

N.L. means no limit.

Book-Entry Only System

The Series 2002-1 Bonds are expected to be available only in book entry form through the facilities of DTC in the United States.

General. 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 securities that its participants (each, a "**Direct Participant**") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (each, an "**Indirect Participant**," and together with Direct Participants, "**DTC Participants**"). The rules applicable to DTC and DTC Participants are on file with the Securities and Exchange Commission.

Purchases of beneficial interests in the Series 2002-1 Bonds under the DTC system must be made by or through Direct Participants, who will receive a credit for the Series 2002-1 Bonds on DTC's records. The ownership interest of each actual purchaser of the Series 2002-1 Bonds (each, a "**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, but each Beneficial Owner is expected to receive written confirmations providing details of the transaction, as well as periodic statements of its holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2002-1 Bonds are to be accomplished by entries made on the books of DTC Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive physical certificates representing their ownership interests in the Series 2002-1 Bonds, except in the event that use of the book-entry system for the Series 2002-1 Bonds is discontinued.

To facilitate subsequent transfers, all of the Series 2002-1 Bonds will be registered in the name of DTC's partnership nominee, Cede & Co., or such other names as may be requested by an authorized representative of DTC. The deposit of the Series 2002-1 Bonds with DTC and their registration in the name of Cede & Co. will effect no change in beneficial ownership. DTC will have no knowledge of the actual Beneficial Owners of the Series 2002-1 Bonds; DTC's records will reflect only the identity of the Direct Participants to whose accounts the Series 2002-1 Bonds are credited, which may or may not be the Beneficial Owners. DTC Participants will remain responsible for keeping account of their holdings on behalf of Beneficial Owners.

Neither DTC nor Cede & Co. will consent or vote with respect to the Series 2002-1 Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to TSASC as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2002-1 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Except as described below, neither DTC nor Cede & Co. will take any action to enforce covenants with respect to any security registered in the name of Cede & Co. Under its current procedures, on the written instructions of a Direct Participant, DTC will cause Cede & Co. to sign a demand to exercise bondholder rights as record holder of the quantity of securities specified in the Direct Participant's instructions, and not as record holder of all the securities of that issue registered in the name of Cede & Co. Also, in accordance with DTC's current procedures, all factual representations to be made by Cede & Co. to TSASC, the Indenture Trustee or any other party must be made to DTC and Cede & Co. by the Direct Participant in its instructions to DTC.

For so long as the Series 2002-1 Bonds are issued in book-entry form through the facilities of DTC, any Beneficial Owner desiring to cause TSASC or the Indenture Trustee to comply with any of its obligations with respect to the Series 2002-1 Bonds must make arrangements with the Direct Participant or Indirect Participant through whom such Beneficial Owner's ownership interest in the Series 2002-1 Bonds is recorded in order for the Direct Participant in whose DTC account such ownership interest is recorded to make the instructions to DTC described above.

None of TSASC, the Indenture Trustee nor any Underwriter (other than in its capacity, if any, as a Direct Participant or Indirect Participant) will have any obligation to Direct Participants or Indirect Participants or the persons for whom they act as nominees with respect to DTC's procedures or any procedures or arrangements between Direct Participants, Indirect Participants and the persons for whom they act relating to the making of any demand by Cede & Co. as the registered owner of the Series 2002-1 Bonds, the adherence to such procedures or arrangements, or the effectiveness of any action taken pursuant to such procedures or arrangements.

Principal and interest payments on the Series 2002-1 Bonds registered in the name of Cede & Co. will be made to DTC. DTC's practice is to credit Direct Participants' accounts on a Distribution Date in accordance with their respective holdings shown on DTC's records. Payments by DTC 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 DTC Participant and not of DTC, the Indenture Trustee, or TSASC, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of TSASC or the Indenture Trustee, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

So long as Cede & Co. is the registered owner of the Series 2002-1 Bonds, as nominee for DTC, references in this Offering Circular to Bondholders or registered owners of the Series 2002-1 Bonds (other than under the caption "TAX EXEMPTION AND OTHER TAX MATTERS" herein) shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the Series 2002-1 Bonds.

As long as the book-entry system is used for the Series 2002-1 Bonds, the Indenture Trustee and TSASC will give any notice of redemption or any other notices required to be given to Bondholders only to DTC or its nominee. Any failure of DTC to advise any Direct Participant, or of any Direct Participant to notify any Indirect Participant, or of any Direct Participant or Indirect Participant to notify any Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Series 2002-1 Bonds called for redemption or of any other action premised on such notice. 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 should make appropriate arrangements with their broker or dealer to receive notices (including notices of redemption) and other information regarding the Series 2002-1 Bonds that may be so conveyed to Direct Participants and Indirect Participants.

If less than all of the Series 2002-1 Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant to be redeemed.

For every transfer and exchange of a beneficial ownership interest in the Series 2002-1 Bonds, the Beneficial Owner may be charged a sum sufficient to cover any tax, fee or other governmental charge, that may be imposed in relation thereto.

The above information concerning DTC and DTC's book-entry system has been obtained from sources that TSASC believes to be reliable, but TSASC takes no responsibility for the accuracy thereof. Neither TSASC nor the Indenture Trustee will have any responsibility or obligation to DTC Participants, Beneficial Owners or other nominees of such Beneficial Owners for (1) sending transaction statements; (2) maintaining, supervising or reviewing, or the accuracy of, any records maintained by DTC or any DTC Participant or other nominees of such Beneficial Owners; (3) payment or the timeliness of payment by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owner, of any amount due in respect of the principal of or redemption premium, if any, or interest on the Series 2002-1 Bonds; (4) delivery or timely delivery by DTC to any DTC Participant, or by any DTC Participant or other nominees of Beneficial Owners to any Beneficial Owners, of any notice (including notice of redemption) or other communication which is required or permitted under the terms of the Indenture to be given to Bondholders; (5) the selection of the Beneficial Owners to receive payment in the event of any partial redemption of the Series 2002-1 Bonds; or (6) any action taken by DTC or its nominee as the registered owner of the Series 2002-1 Bonds.

None of TSASC, the City, the Indenture Trustee or the Underwriters can give any assurance that DTC or DTC Participants will distribute payments of principal, premium or interest on the Series 2002-1 Bonds paid to DTC or its nominee, or send any redemption or other notices, to the Beneficial Owners, or that they will do so in a timely manner or that DTC will act in the manner described in this Offering Circular.

Distributions in respect of the Series 2002-1 Bonds will be forwarded by the Indenture Trustee to DTC, and DTC will be responsible for forwarding those payments to participants, each of which will be responsible for disbursing payments to the Bondholders it represents or, if applicable, to Indirect Participants. Accordingly, Bondholders may experience delays in the receipt of payments in respect of their Series 2002-1 Bonds. Under DTC's procedures, DTC will take actions permitted to be taken by holders of the Series 2002-1 Bonds under the Indenture only at the direction of one or more Direct Participants to whose account the Series 2002-1 Bonds are credited and whose aggregate holdings represent no less than any minimum amount of percentage interests or voting rights required therefor. DTC may take conflicting actions as to any action of Bondholders to the extent that Direct Participants authorize the actions. None of TSASC, the Indenture Trustee or any of their respective affiliates will have any liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Series 2002-1 Bonds or for maintaining, supervising or reviewing any records relating to the beneficial ownership interests.

SECURITY

Sale of TSRs

Pursuant to the TSR Purchase Agreement, the City sold to TSASC all of the City's right, title and interest under the MSA and the Decree, including the City's right to receive its allocable share of (i) the Initial Payments made by the OPMs under the MSA, and (ii) Annual Payments made by the PMs under the MSA, which are required to be made annually on each April 15 (referred to herein as Tobacco Settlement Revenues or TSRs).

The Series 2002-1 Bonds will be secured upon issuance thereof, together with all other Senior Bonds issued or to be issued, by a perfected first-priority security interest in, and pledge of, TSASC's tangible and intangible assets, including its right to receive its allocated portion of the Initial Payments and Annual Payments under the MSA and the Decree.

Payment by MSA Escrow Agent to Indenture Trustee

The New York State Attorney General and the City have issued irrevocable instructions directing the MSA Escrow Agent to disburse TSASC's portion of TSRs directly to the Indenture Trustee. The moneys to which TSASC is entitled do not pass through the State or the City and are not subject to State or City appropriation.

Accounts

All of the following funds and accounts were established and are being held by the Indenture Trustee for the benefit of the holders of the Program Bonds, including the Series 2002-1 Bonds. All funds on deposit in the following accounts will be invested in Eligible Investments.

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

Bond Fund. Under the Indenture, the Indenture Trustee established and holds a segregated trust fund (the "**Bond Fund**") which includes the Debt Service Account, the Liquidity Reserve Account, the Extraordinary Prepayment Account and the Trapping Account.

Debt Service Account. Under the Indenture, the Indenture Trustee established and holds a segregated trust account (the "**Debt Service Account**") into which the Indenture Trustee deposits amounts transferred from the Collection Account in respect of interest and principal payments on the Senior Bonds and from which the Indenture Trustee makes payments on the Senior Bonds in accordance with the priority of payments as described below.

Liquidity Reserve Account. Under the Indenture, the Indenture Trustee established and holds a segregated trust account (the "**Liquidity Reserve Account**") which was initially funded from Series 1999-1 Bond proceeds. At any time, the Liquidity Reserve Account is required to maintain a balance (the "**Liquidity Reserve Requirement**") equal to the maximum annual Debt Service (as herein defined) past, present or future (including in each Fiscal Year, Principal Installments but not Super Sinker Redemptions) on all Senior Bonds, assuming that all Principal Installments have been and will be paid on their respective Principal Installment Payment Dates. Prior to the issuance of the Series 2002-1 Bonds, the Liquidity Reserve Account is funded at $56,820,277.12 for the outstanding Program Bonds. An additional $7,661,009.64 is assumed to be deposited from the proceeds of the TIFIA loan as it is disbursed. Upon the issuance of the Series 2002-1 Bonds, a deposit of $41,718,502.44 will be made to the Liquidity Reserve Account, which will bring its balance to the Liquidity Reserve Requirement. Upon the issuance of Additional Bonds, the Cash Flow Assumptions assume that the Liquidity Reserve Account will be fully funded at maximum annual Principal Installments Debt Service on all Program Bonds outstanding as of the date of issuance.

Amounts in the Liquidity Reserve Account are available to pay interest and Principal Installments of the Senior Bonds, in that order, to the extent Collections are insufficient for such purpose. Amounts in the Liquidity Reserve Account are not available to make Super Sinker Redemptions. Amounts withdrawn from the Liquidity Reserve Account will be replenished as described in "SECURITY—Flow of Funds" herein. On each Distribution Date, amounts on deposit in the Liquidity Reserve Account in excess of the Liquidity Reserve Requirement will be transferred to the Collection Account. All funds on deposit in the Liquidity Reserve Account will be invested in Eligible Investments.

Extraordinary Prepayment Account. Under the Indenture, the Indenture Trustee established and holds a segregated trust account (the "**Extraordinary Prepayment Account**") into which the Indenture Trustee will deposit, following the occurrence of any Event of Default, Collections after the payment of certain expenses, all current and past due interest on the Senior Bonds, current and past due Principal Installments, current and past due Super Sinker Redemptions and the replenishment of the Liquidity Reserve Account. The Indenture Trustee will make Extraordinary Prepayments on the Senior Bonds from the Extraordinary Prepayment Account.

Trapping Account. Under the Indenture, the Indenture Trustee established and holds a segregated trust account designated as the Trapping Account. The Trapping Account is funded from Collections to the Trapping Requirement, at the Trapping Amount, during the existence of a Trapping Event. "**Trapping Event**" means a Consumption Decline Trapping Event, a Downgrade Trapping Event, a Lump Sum Trapping Event, a Model Statute Trapping Event or an NPM Trapping Event. "**Trapping Requirement**" means the greatest of the Consumption Decline Trapping Requirement, the Downgrade Trapping Requirement, the Lump Sum Trapping Requirement, the Model Statute Trapping Requirement or the NPM Trapping Requirement. "**Trapping Amount**" means (i) a fraction of the money available, prior to the deposit for Junior Payments (as hereinafter defined), equal to the ratio of the initial principal amount of previously issued Program Bonds to $2.76 billion, or (ii) in the event of a Lump Sum Trapping Event only, the lump sum, or (iii) with respect to a Trapping Event that is not in effect, zero.

"**Consumption Decline Trapping Event**" means shipments of cigarettes in or to the 50 United States, the district of Columbia and Puerto Rico are less in any year preceding a Deposit Date than the amounts set forth below for such year:

Year	Shipments
1999	367,242,500,000
2000	366,132,905,223
2001	365,131,767,078
2002	359,875,791,817
2003	354,553,074,013
2004	347,895,505,350
2005	340,103,313,456
2006	332,010,780,118
2007	324,468,872,759
2008	317,502,619,835
2009	311,796,132,409
2010	305,664,161,271
2011	299,340,305,323
2012	292,716,107,931
2013	285,975,111,088
2014	278,975,486,892
2015	274,144,995,343
2016	261,174,858,073
2017	256,308,296,105
2018	243,924,364,479
2019	239,393,723,619
2020	227,310,624,191
2021	223,705,054,607
2022	212,653,520,071
2023	208,575,354,392
2024	197,908,325,609
2025	195,239,850,775
2026	186,130,229,787
2027	182,646,857,948
2028	172,744,914,629
2029	169,359,448,221
2030	159,635,403,235
2031	157,147,280,493
2032	148,354,931,961
2033	145,588,306,328
2034	137,091,146,323
2035	133,981,729,026
2036	125,769,206,337
2037	123,675,404,428
2038	116,398,013,471
2039	114,422,237,897
2040	107,160,060,315
2041	105,088,587,712
2042	97,993,757,241

"**Consumption Decline Trapping Requirement**" means 25% of the principal amount of the Outstanding Program Bonds until (i) two years after the end of a Consumption Decline Trapping Event of no more than two years' duration or (ii) three years after the end of a Consumption Decline Trapping Event of more than two years' duration, and thereafter zero.

"**Downgrade Trapping Event**" means, as of any Deposit Date, that an OPM with a Market Share (as defined in the MSA) of 7% or more in the calendar year preceding such Deposit Date is rated (or if such OPM is not rated, whose parent corporation is rated) below Baa3 by Moody's or BBB- by S&P. "**Downgrade Trapping Requirement**" means 25% of the principal amount of Outstanding Program Bonds until one year after the end of a Downgrade Trapping Event, and thereafter zero, and in any event zero if the applicable OPM has assumed the MSA in bankruptcy and is current on all MSA payments.

"**Lump Sum Trapping Event**" means the receipt after June 30, 2002 of a lump sum in lieu of future TSRs that causes (or is expected to cause, as evidenced by an officer's certificate of TSASC) the amount available prior to the deposit for Junior Payments in a fiscal year to exceed the sum of the amounts (excluding any such lump sums) that were so available over the three preceding Fiscal Years. "**Lump Sum Trapping Requirement**" means the lump sum until there has occurred a twelve-month period, commencing at least twelve months after the most recent Lump Sum Trapping Event, in which the Trapping Account was at no point reduced below the Lump Sum Trapping Requirement and thereafter zero.

"**Model Statute Trapping Event**" means, as of any Deposit Date, that (a) the aggregate Market Share of the NPMs exceeds 3% in the calendar year preceding such Deposit Date and (b) the Model Statute (as hereinafter defined) is found to be invalid (i) in the New York Supreme Court or United States District Court in the State of New York and an appeal of such finding has not been filed within three months or after such three month period the finding of such court has not been stayed or (ii) in 25 states that in aggregate account for at least 50% of the payments under the MSA or (iii) by an appellate court having jurisdiction over New York on federal or New York State law or (iv) on federal grounds in any United States Court of Appeals. "**Model Statute Trapping Requirement**" means 25% of the principal amount of the Outstanding Program Bonds until one year after the end of a Model Statute Trapping Event, and thereafter zero.

"**NPM Trapping Event**" means, as of any Deposit Date, that the aggregate Market Share of the NPMs exceeds 7% in the calendar year preceding such Deposit Date. "**NPM Trapping Requirement**" means the lesser of (i) 6% of the principal amount of Outstanding Program Bonds for each full percentage point by which the aggregate Market Share of the NPMs exceeds 7% and (ii) 65% of such principal amount, which amount, as calculated immediately prior to the NPM Trapping Event ceasing to be in effect, shall remain the same for one year and thereafter shall be zero.

Following the occurrence of a Trapping Event, amounts deposited in the Trapping Account will be available to pay interest, Principal Installments, Super Sinker Redemptions and Extraordinary Prepayments, in that order, to the extent Collections or other amounts are insufficient for such purposes. On each Distribution Date, amounts on deposit in the Trapping Account in excess of the Trapping Requirement will be transferred to the Collection Account. All funds on deposit in the Trapping Account will be invested in Eligible Investments.

Amounts in the Trapping Account in excess of the Trapping Requirement on any Distribution Date will be transferred into the Collection Account.

Flow of Funds

The Indenture Trustee deposits the Collections into the Collection Account. Amounts deposited during the period January 1 through June 30 in any Fiscal Year are applied to expenses and debt service requirements on the Bonds for the current and the next Fiscal Year. Amounts, if any, deposited during the period July 1 through December 31 in any Fiscal Year will be applied to expenses and debt service requirements on the Bonds for the current Fiscal Year only.

No later than five Business Days following each deposit of TSRs to the Collection Account (each, a "**Deposit Date**"), the Indenture Trustee is required to withdraw Collections on deposit in the Collection Account (to the extent Collections are in excess of amounts required to pay Trustee fees and expenses), and transfer such amounts as follows:

(i) to TSASC in an amount specified by officer's certificate of TSASC, not exceeding with other applicable transfers the Operating Cap and the amount necessary to provide for Priority Payments, in each case for the current Fiscal Year and, if the Deposit Date is between January 1 and June 30, for the following Fiscal Year;

(ii) to the Debt Service Account an amount sufficient to cause the amount on deposit therein to equal interest (including interest at the stated rate on principal of Outstanding Bonds and on overdue interest, if any) due on Senior Bonds on the next Distribution Date and, in the case of Parity Payments and interest due at variable rates on Senior Bonds, to deposit in separate subaccounts within the Debt Service Account, Senior Bond interest and Parity Payments due during the Semiannual Period including such Distribution Date, together with any unpaid interest and other Parity Payments due on prior Distribution Dates;

(iii) to the Debt Service Account an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to clause (ii) above) to equal the Principal Installments due during the current Fiscal Year and any past due Principal Installments and, if the Deposit Date is during the period from January 1 through June 30 of any year, the principal Installments due during the next Fiscal Year;

(iv) to replenish the Liquidity Reserve Account until the amount on deposit therein equals the Liquidity Reserve Requirement;

(v) to the Debt Service Account an amount, together with the amount deposited pursuant to clause (ii) above (but without regard to amounts on deposit therein pursuant to clause (iii) above), sufficient to cause the amount therein to equal Senior Bond interest and Parity Payments due (a) during the current Fiscal Year and, in the case of Parity Payments and interest due at variable rates on Senior Bonds, to deposit in separate subaccounts within the Debt Service Account, Senior Bond interest and Parity Payments due during such Fiscal Year and (b) if the Deposit Date is during the period from January 1 through June 30 of any year, during the next Fiscal Year (or, in the case of variable-rate Senior Bonds, interest on parity BANs and swap payments, during the last complete Semiannual Period in such next Fiscal Year), assuming that principal payments will be made on the Bonds in the amounts deposited pursuant to clause (iii) above and clause (vi) below;

(vi) to the Debt Service Account an amount which, together with amounts deposited pursuant to clause (iii) above (but without regard to amounts on deposit therein pursuant to clauses (ii) and (v) above), will be sufficient to cause the amount therein to equal the Super Sinker Redemptions due during the current Fiscal Year and any past due Super Sinker Redemptions and, if the Deposit Date is during the period from January 1 through June 30 of any year, the Super Sinker Redemptions due during the next Fiscal Year;

(vii) if an Event of Default has occurred, to the Extraordinary Prepayment Account all amounts remaining;

(viii) if a Trapping Event has occurred and is continuing, to the Trapping Account, the lesser of the Trapping Amount or the amount required to make the amount therein equal to the Trapping Requirement;

(ix) in the amounts and to the accounts established by Series Supplement for Junior Payments; and

(x) to TSASC to pay Operating Expenses, if any, specified by officer's certificate.

Notwithstanding the date of actual receipt, all Initial Payments shall be deemed to be received no earlier than the month when due.

"**Operating Cap**" means $1,000,000 in the Fiscal Year ending June 30, 2000, inflated in each following Fiscal Year by the Inflation Adjustment applicable pursuant to the MSA to the calendar year ending in such Fiscal Year, plus arbitrage rebate and penalties specified by officer's certificate of TSASC. The Operating Cap for the Fiscal Year ending June 30, 2002 was $1,060,900.

"**Priority Payments**" means fees payable pursuant to Ancillary Contracts that are identified by Series Supplement as Priority Payments, which shall not include payments of or in lieu of interest, principal or purchase price of Bonds.

"**Ancillary Contracts**" means contracts entered into by TSASC or for its benefit or the benefit of any of the beneficiaries of such contracts to facilitate the issuance, sale, resale, purchase, repurchase or payment of Bonds, including bond insurance, letters of credit and liquidity facilities, but excluding Swap Contracts.

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

"**Parity Payments**" means (i) BAN interest identified as Debt Service or Parity Payments by a Series Supplement and (ii) Swap payments not to exceed the applicable Maximum Rate, and does not include any payments under Ancillary Contracts.

"**Distribution Date**" means (i) each July 15 (which shall be the date specified in each Series Supplement as the date of payment of Principal Installments and Super Sinker Redemptions) and January 15, (ii) each additional distribution date selected by TSASC or the Indenture Trustee following an Event of Default, and (iii) each Distribution Date to the extent so characterized in a Supplemental Indenture.

"**Debt Service**" means interest (not to exceed the Maximum Rate), redemption premium, Super Sinker Redemptions and, without duplication, Principal Installments due on outstanding Senior Bonds and Parity Payments. For purposes of clause (1)(b) under the caption "THE SERIES 2002-1 BONDS—Additional Series of Bonds", Debt Service includes in each year the greater of Debt Service (including interest payable as Debt Service at a default rate, if any) on each Series of BANs in anticipation of Senior Bonds and assumed Debt Service on the related authorized but unissued Series of Bonds.

"**Maximum Rate**" means (i) the highest rate payable on a Bond to holders other than parties to Ancillary Contracts, as specified by Series Supplement, or (ii) the rate specified by Series Supplement as the Maximum Rate on a Swap.

"**Junior Payments**" means (i) termination payments on Swaps and any other payments thereon in excess of the applicable Maximum Rate, (ii) BAN interest payable other than as Parity Payments, (iii) amounts payable to or for the benefit of the holders of Subordinate Bonds, (iv) Bond principal payable under term-out provisions of Ancillary Contracts, (v) other amounts due under Ancillary Contracts and not payable as Priority Payments or Debt Service, (vi) purchase price of Bonds, (vii) principal of BANs if payable from TSRs pursuant to a Series Supplement and (viii) Junior Payments so identified in or by reference to the Indenture.

"**Semiannual Period**" means (i) with respect to Initial Payments and other Collections received in January, February and March, each six-month period beginning February 1 or August 1, and (ii) with respect to all other collections, each six-month period beginning May 1 or November 1.

In calculating deposits to the Bond Fund, Swap payments and interest on variable-rate Bonds shall be assumed at the Maximum Rate; and money so deposited will be transferred to the Collection Account pursuant to officer's certificates of TSASC reporting accruals at lower rates.

After making the deposits set forth above, any amounts remaining in the Collection Account in excess of amounts required to be applied to make payments from the Collection Account described below during the current Fiscal Year and, if the Deposit Date is during the period from January 1 through June 30 of any year, during the next Fiscal Year, will be paid to the holder of the Residual Certificate.

In addition, investment earnings on amounts on deposit under the Indenture will be applied in accordance with the requirements set forth above.

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

(i) from the Collection Account, to the Trustee, to pay Trustee fees and expenses pursuant to the Indenture;

(ii) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay Senior Bond interest (including interest at the stated rate on principal of Outstanding Bonds and on overdue interest, if any) and Parity Payments due on such Distribution Date, plus any such unpaid interest and Parity Payments from prior Distribution Dates;

(iii) from the Debt Service Account, the Liquidity Reserve Account and the Trapping Account, in that order, to pay the Principal Installments due on such Distribution Date and any past due Principal Installments;

(iv) from the Liquidity Reserve Account, any amount remaining in excess of the Liquidity Reserve Requirement, to the Collection Account;

(v) from the Debt Service Account and the Trapping Account, in that order, in the amount required to make Super Sinker Redemptions due on such Distribution Date and any past due Super Sinker Redemptions;

(vi) from the Extraordinary Prepayment Account and the Trapping Account, in that order, if an Event of Default has occurred, to pay Extraordinary Prepayments on Senior Bonds pro rata;

(vii) from the Trapping Account, any amount remaining in excess of the Trapping Requirement, to the Collection Account;

(viii) from the Accounts therefor, to make Junior Payments;

(ix) from the Collection Account, to pay Operating Expenses specified by officer's certificate of TSASC; and

(x) from the Collection Account, any amounts remaining to the holder of the Residual Certificate.

Available money will be allocated among each of the outstanding Series of Bonds according to the above priority of payments on a pro rata basis, except for Super Sinker Redemptions. For this purpose, "**pro rata**" means that money will be allocated to each Series by the application of a fraction, the numerator of which is equal to the amount due on such Series and the denominator of which is equal to the sum of similar amounts due for the same level of priority for all of the outstanding Series. Money available to pay Principal Installments on any Distribution Date will first be allocated pro rata among all Series of Senior Bonds according to the Principal Installments due on such Distribution Date and any past due Principal Installments on each Series of Senior Bonds, and for any Series of Senior Bonds in order of Principal Installments, and if no Event of Default has occurred, within a Principal Installment by lot in $5,000 denominations or, if an Event of Default has occurred, in equal proportions among the Senior Bonds within a Principal Installment. Money available to pay Super Sinker Redemptions on Senior Bonds will be allocated (i) in order of Super Sinker Redemption Dates of the Senior Bonds, (ii) pro rata within the same Super Sinker Redemption Date according to Super Sinker Redemptions then due on each Series of Senior Bonds and (iii) for any Series of Senior Bonds, in order of Principal Installments, and in each case, if no Event of Default has occurred, within a Principal Installment, by lot in $5,000 denominations or, if an Event of Default has occurred, in equal proportions among the Senior Bonds within a Principal Installment, with Principal Installments paid in ascending order of maturity.

Events of Default

"**Event of Default**" means any one of the events set forth below:

(i) failure to pay when due interest on any BANs (if Debt Service) or Senior Bonds, or any Principal Installment at or prior to its Principal Installment Payment Date;

(ii) failure of TSASC to observe or perform any other provision of the Indenture which is not remedied within 30 days after written notice thereof is given to TSASC by the Indenture Trustee or to TSASC and the Indenture Trustee by the holders of at least 25% in principal amount of the Senior Bonds then Outstanding, if a majority in interest of the holders of the Senior Bonds declares such failure to be an Event of Default, provided that, except as specified in clause (i) above, failure to make any payment or provision therefor because of insufficiency of available Collections will not constitute a default;

(iii) bankruptcy, reorganization, arrangements or insolvency proceedings, or other proceedings for relief under any bankruptcy or similar law or laws for the relief of debtors, are instituted by or against TSASC and, if instituted against TSASC, are not dismissed within 60 days after such institution; or

(iv) failure by the City to observe or perform its covenant to not limit or alter the rights of TSASC to fulfill the terms of TSASC's agreements with the holders of the outstanding Bonds under the Indenture, or in any way impair the rights and remedies of such holders or the security for the Bonds until the Bonds are fully paid and discharged, which failure is not remedied within 30 days after written notice thereof is given by the Indenture Trustee to the City and TSASC or by TSASC to the Indenture Trustee and the City, if a majority in interest of the holders of the Senior Bonds declares such failure to be an Event of Default.

THE INDENTURE

The following summary describes certain terms of the Indenture pursuant to which the Series 2002-1 Bonds will be issued. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture, the Series 2002-1 Supplement and the Series 2002-1 Bonds. Copies of the Indenture and the Series 2002-1 Supplement may be obtained upon written request to the Indenture Trustee. See "SECURITY" and "THE SERIES 2002-1 BONDS" for further descriptions of certain terms and provisions of the Series 2002-1 Supplement and Series 2002-1 Bonds.

Directors, State and City Not Liable on Bonds

Neither the members, directors or officers of TSASC nor any person executing the Bonds or other obligations of TSASC will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance thereof.

The Bonds and other obligations of TSASC will not be a debt of either the State or the City, and neither the State nor the City will be liable thereon, nor will they be payable out of any funds other than those of TSASC; and the Bonds will contain on the face thereof a statement to such effect. (Section 103)

Separate Accounts and Records

The parties to the Indenture represent and covenant, each for itself, that: (a) TSASC and the Indenture Trustee each will maintain its respective books, financial records and accounts (including, without limitation, inter-entity transaction accounts) in a manner so as to identify separately the assets and liabilities of each such entity; each has observed and will observe all applicable corporate or trust procedures and formalities, including, where applicable, the holding of regular periodic and special meetings of governing bodies, the recording and maintenance of minutes of such meetings, and the recording and maintenance of resolutions, if any, adopted at such meetings; and all transactions and agreements between TSASC and the Indenture Trustee have reflected and will reflect the separate legal existence of each entity and have been and will be formally documented in writing; and (b) TSASC and the Indenture Trustee, in its individual capacity, have paid and will pay their respective liabilities and losses from their own respective separate assets. In furtherance of the foregoing, TSASC has compensated and will compensate all consultants, independent contractors and agents from its own funds for services provided to it by such consultants, independent contractors and agents. (Section 104)

Security and Pledge

Pursuant to the Indenture, TSASC assigns and pledges to the Indenture Trustee in trust upon the terms thereof (a) the Revenues, (b) all rights to receive the Revenues and the proceeds of such rights, (c) the TSRs, (d) all Accounts and assets thereof, including money, contract rights, general intangibles or other personal property, held by the Indenture Trustee under the Indenture, (e) subject to the following sentence, all rights and interest of TSASC under the TSR Purchase Agreement, including the representations, warranties and covenants of the City in the TSR Purchase Agreement and (f) any and all other property conveyed, pledged, assigned or transferred as and for additional security. Except as specifically provided in the Indenture, such assignment and pledge does not include: (i) the rights of TSASC pursuant to provisions for consent or other action by TSASC, notice to TSASC, indemnity or the filing of documents with TSASC, or otherwise for its benefit and not for that of the Beneficiaries, (ii) any right or power reserved to TSASC pursuant to the Act or other law or (iii) matters required by the Local Law (as herein defined) to be set forth in the TSR Purchase Agreement; nor does this paragraph preclude TSASC's enforcement of its rights under and pursuant to the TSR Purchase Agreement for the benefit of the Beneficiaries as provided in the Indenture. TSASC will implement, protect and defend such assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. The collateral is pledged and a security interest is therein granted to secure the payment of Bonds, the Residual Certificate and payments in respect of Swaps and Ancillary Contracts, all with the respective priorities specified in the Indenture. The lien of such pledge and the obligation to perform the contractual provisions made in the Indenture will have priority over any or all other obligations and liabilities of TSASC secured by the Revenues. (Section 201)

Defeasance

When (a) there is held by or for the account of the Indenture Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all obligations to Beneficiaries (including parties to Swaps and Ancillary Contracts but excluding for this purpose the holder of the Residual Certificate) in full (to be verified by a nationally recognized firm of independent certified public accountants), (b) any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Indenture Trustee, and (c) all the rights of the Fiduciaries have been provided for, *then* upon written notice from TSASC to the Indenture Trustee, such Beneficiaries will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture, the security interests created by the Indenture (except in such funds and investments) will terminate, and TSASC and the Indenture Trustee will execute and deliver such instruments as may be necessary to discharge the Indenture Trustee's lien and security interests created in the Indenture and to make the TSRs payable to the order of TSASC. Upon such defeasance, the funds and investments required to pay or redeem the Bonds and other obligations to such Beneficiaries will be irrevocably set aside for that purpose, subject, however, to TSASC's rights to money deposited with the Indenture Trustee or a Paying Agent with respect to payments on any Bond that remains unclaimed for two years after such payments has become due and payable (Section 506 of the Indenture), and money held for defeasance will be invested only as above and applied to the retirement of the Bonds and such other obligations. (Section 202)

Bonds of TSASC

By Series Supplement complying procedurally and in substance with the Indenture, TSASC may authorize, issue, sell and deliver Bonds from time to time in such principal amounts as TSASC will determine; and may issue Bonds to renew or refund Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine. See "THE SERIES 2002-1 BONDS —Additional Series of Bonds."

Residual Certificate

Subject to the provisions of the Indenture for the benefit of the Holders, Fiduciaries and parties to Swaps and Ancillary Contracts, all Collections will be paid to the registered owner of the Residual Certificate. At delivery of the Series 1999-1 Bonds, the Residual Certificate was delivered to the Trust in exchange for the beneficial interest in the Trust. The Residual Certificate, among other things, provides for the payment to the City of the net proceeds of the various Series of Tobacco Bonds issued after the Series 1999-1 Bonds pursuant to the Local Law. (Article IV)

Bond Fund

A Bond Fund is established with the Indenture Trustee and money is deposited therein as provided in the Indenture. The money in the Bond Fund is held in trust and, except as otherwise provided in the Indenture, will be applied solely to the payment of Debt Service. The Bond Fund includes the Debt Service Account, the Liquidity Reserve Account, the Trapping Account, the Extraordinary Prepayment Account and such other Accounts as may be established in the Bond Fund by Supplemental Indenture. (Section 502)

Swaps and Ancillary Contracts

TSASC may enter into, amend or terminate, as it determines to be necessary or appropriate, Swaps or Ancillary Contracts, and may by Series Supplement provide for the payment of amounts due thereunder as Junior Payments or, to the extent permitted, as Parity Payments or Priority Payments. (Section 503)

Redemption of the Bonds

When a Bond is to be redeemed prior to its Super Sinker Redemption Date, or as a sinking fund installment, or after its Super Sinker Redemption Date but prior to its Principal Installment Payment Date, the Indenture Trustee will give notice in the name of TSASC, which notice will identify the Bonds to be redeemed, state the date fixed for redemption and state that such Bonds will be redeemed at the corporate trust office of the Indenture Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Bond to be redeemed the redemption price thereof, together with interest accrued to the redemption date, and that money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest thereon will cease to accrue. The Indenture Trustee will give 30 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of TSASC. Such notice may be waived by any Holder of Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice to such Holder, will not affect the redemption of any other Bond.

Unless otherwise specified by Series Supplement: (a) if less than all the Outstanding Bonds of like Principal Installments and Super Sinker Redemptions are to be redeemed, the particular Bonds to be redeemed will be selected by the Indenture Trustee by such method as it will deem fair and appropriate and which may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination, and (b) the Indenture Trustee will redeem any and all Bonds held by the provider of an Ancillary Contract prior to any other Bonds redeemed unless otherwise directed by an officer's certificate of TSASC. (Section 504)

Investments

Pending its use under the Indenture, money in the Accounts may be invested by the Indenture Trustee in Eligible Investments maturing or redeemable at the option of the holder at or before the time when such money is expected to be needed and will be so invested pursuant to written direction of TSASC if there is not then an Event of Default actually known to the Indenture Trustee. Investments will be held by the Indenture Trustee in the respective Accounts and will be sold or redeemed to the extent necessary to make payments or transfers from each Account. The Indenture Trustee will not be liable for any losses on investments made at the direction of TSASC.

In computing the amount in any Account, the value of Eligible Investment will be determined at least as frequently as each Distribution Date and will be calculated as follows:

(a) As to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal (or, if not there, then in The New York Times): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(b) As to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal or The New York Times: the average bid price at such time of determination for such investments by any two nationally recognized government securities dealers (selected by the Indenture Trustee in its absolute discretion) at the time making a market in such investments or the bid price published by a nationally recognized pricing service;

(c) As to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest; and

(d) As to any investment not specified above: the value thereof established by prior agreement between TSASC and the Indenture Trustee.

The Indenture Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible) and may make interfund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, this section will be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 505)

Contract; Obligations to Beneficiaries

In consideration of the purchase and acceptance of any or all of the Bonds and Swaps and Ancillary Contracts by those who will hold the same from time to time, the provisions of the Indenture will be a part of the contract of TSASC with the Beneficiaries. The pledge made in the Indenture and the covenants to be performed by TSASC will be for the equal benefit, protection and security of the Beneficiaries of the same priority. All of the Bonds or payments on Swaps or Ancillary Contracts of the same priority, regardless of the time or times of their issuance or maturity, will be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided.

Under the Indenture, TSASC covenants to pay when due all sums payable on the Bonds, from the Revenues and money designated in the Indenture, subject only to (1) the Indenture, and (2) to the extent permitted by the Indenture, (x) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (y) the rights of Beneficiaries under Swaps and Ancillary Contracts. The obligation of TSASC to pay principal, interest and redemption premium, if any, to the Holders of Bonds is and will be absolute and unconditional, is and will be binding and enforceable in all circumstances whatsoever, and is not and will not be subject to setoff, recoupment or counterclaim.

In addition, TSASC represents under the Indenture that it is duly authorized pursuant to law, including the Act, to create and issue the Bonds, to enter into the Indenture and to pledge the Revenues and other collateral purported to be pledged. The Revenues and other collateral so pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all corporate action on the part of TSASC to that end has been duly and validly taken. The Bonds and the provisions of the Indenture are and will be the valid and binding obligations of TSASC in accordance with their terms. (Section 601)

Operating Expenses; Priority Payments

TSASC will pay its Operating Expenses and make Priority Payments to the parties entitled thereto. TSASC may borrow money to pay, and repay such borrowings as, Operating Expenses. The aggregate amount of such outstanding borrowings will never exceed the Operating Cap and will be zero for at least 30 days of each Fiscal Year. (Section 602)

Tax Covenants

TSASC makes the following covenants under the Indenture:

(a) TSASC will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by TSASC on Tax-Exempt Bonds will be excludable from gross income for Federal income tax purposes pursuant to § 103(a) of the Code; and no funds of TSASC will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations thereunder. If and to the extent required by the Code, TSASC will periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty.

(b) The property of TSASC is irrevocably dedicated to charitable purposes. No part of the income or earnings of TSASC will inure to the benefit or profit of, nor will any distribution of its property or assets be made to, any member, director or officer of TSASC, or private person, corporate or individual, or to any other private interest, except that TSASC may repay loans made to it and may repay contributions (other than dues) made to it to the extent that any such contribution may not be allowable as a deduction in computing taxable income under the Code.

(c) TSASC will not attempt to influence legislation by propaganda or otherwise, or participate in or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

(d) TSASC will not engage in any activities not permitted to be carried on by an organization exempt from federal income taxation pursuant to § 501(c)(3) of the Code and the regulations thereunder. (Section 603)

Accounts and Reports

TSASC will:

(a) cause to be kept books of account in which complete and accurate entries will be made of its transactions relating to all funds and accounts under the Indenture, which books will at all reasonable times be subject to the inspection of the Indenture Trustee and the Holders of an aggregate of not less than 25% in principal amount of Bonds then Outstanding or their representatives duly authorized in writing;

(b) annually, within 185 days after the close of each fiscal year, deliver to the Indenture 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;

(c) keep in effect at all times by officer's certificates, an accurate and current schedule of all Debt Service (separately shown for Principal Installments and Super Sinker Redemptions) to be payable during the life of then Outstanding Bonds, Swaps and Ancillary Contracts; certifying for the purpose such estimates as may be necessary; and

(d) for each Distribution Date, provide to the Indenture Trustee and each Rating Agency a statement indicating:

(1) the amount of principal to be paid to Bondholders of each Series on such Distribution Date;

(2) the amount of interest to be paid to Bondholders of each Series on such Distribution Date;

(3) the sum of the Principal Installments for such Distribution Date, if any, plus the aggregate Principal Installments for each prior Principal Installment Payment Date over principal payments, including Super Sinker Redemptions, previously made on the applicable Bonds, and (y) the sum of the Super Sinker Redemptions for such Distribution Date, if any, plus the aggregate Super Sinker Redemptions for each prior Super Sinker Redemption Date over principal payments, including Super Sinker Redemptions, previously made on the applicable Bonds, in each case for each Series as of that Distribution Date;

(4) the amount on deposit in each Account as of that Distribution Date;

(5) the Liquidity Reserve Requirement as of that Distribution Date;

(6) whether or not a Trapping Event has occurred and is continuing; and

(7) the Trapping Requirement, if any, as of that Distribution Date. (Section 807)

Ratings

Unless otherwise specified by Series Supplement, TSASC will pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Senior Bonds from at least two nationally recognized statistical rating organizations. (Section 606)

TIFIA Loan Agreement

Pursuant to a Secured Loan Agreement and Inducement Agreement dated as of December 1, 2001 (the "**TIFIA Loan Agreement**") between TSASC, the United States Department of Transportation and the

City of New York, TSASC issued approximately $42.6 million of Senior Bonds, and has the ability to issue an additional approximately $116.6 million of Senior Bonds, plus capitalized interest. Pursuant to the TIFIA Loan Agreement, borrowings thereunder were applied by the City towards the Staten Island Ferries and Ferry Terminals Project.

Affirmative Covenants

TSASC makes the following affirmative covenants under the Indenture:

Maintenance of Existence. TSASC will keep in full effect its existence, rights and franchises as not-for-profit corporation under the laws of the State.

Protection of Collateral. TSASC will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (a) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (b) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (c) preserve and defend title to the Revenues and other collateral and the rights of the Indenture Trustee and the Holders in such collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Decree, the Indenture or the TSR Purchase Agreement or the performance by any party thereunder; (d) enforce the TSR Purchase Agreement; (e) pay any and all taxes levied or assessed upon all or any part of the collateral; or (f) carry out more effectively the purposes of the Indenture.

Performance of Obligations. TSASC (a) will diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the collateral and (b) will not take any action and will use its best efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Indenture, the TSR Purchase Agreement or the Decree.

Notice of Events of Default. TSASC will give the Indenture Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture. (Section 607)

Negative Covenants

TSASC makes the following negative covenants under the Indenture:

Sale of Assets. Except as expressly permitted by the Indenture, TSASC will not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are pledged under the Indenture.

Liquidation. TSASC will not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. TSASC will not (1) permit the validity or effectiveness of the Indenture to be impaired, or permit the lien of 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 lien of 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 lien of the Indenture not to constitute a valid first priority security interest in the collateral.

Limitations on Consolidation, Merger, Sale of Assets, etc. Except as otherwise provided in the Indenture, TSASC will not consolidate or merge with or into any other person, or convey or transfer all or substantially all of its properties or assets, unless:

(a) the person surviving such consolidation or merger (if other than TSASC or the transferee) is organized and existing under the laws of the United States or any state thereof and expressly assumes the due and punctual payment of the principal of and premium, if any, and interest on all Bonds and the performance or observance of every agreement and covenant of TSASC in the Indenture;

(b) immediately after giving effect to such transaction, no Default has occurred and is continuing under the Indenture;

(c) TSASC has received Rating Confirmation;

(d) TSASC has received an opinion of Counsel to the effect that such transaction will not have material adverse tax consequences to TSASC or any Holder;

(e) any action as is necessary to maintain the lien and security interest created by the Indenture has been taken; and

(f) TSASC has delivered to the Indenture Trustee an officer's certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

No Other Business. TSASC will not engage in any business other than financing, purchasing, owning and managing the collateral in the manner contemplated by the Indenture and activities incidental thereto.

No Borrowing. TSASC will not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness except Permitted Indebtedness. Swaps and Ancillary Contracts are not indebtedness within the meaning of this covenant.

Guarantees, Loan, Advances and Other Liabilities. Except as otherwise contemplated by the Indenture and the TSR Purchase Agreement, TSASC will not make any loan or advance of credit to, or guarantee (directly or indirectly or by an instrument having the effect of assuring another's payment or performance on any obligation or capability of so doing or otherwise), endorse or otherwise become contingently liable, directly or indirectly, in connection with the obligations, stock or dividends of, or own, purchase, repurchase or acquire (or agree contingently to do so) any stock, obligations, assets or securities of, or any other interest in, or make any capital contribution to, any other person.

Restricted Payments. TSASC will not, directly or indirectly, make payments to or distributions from the Collection Account except in accordance with the Indenture.

Directors. TSASC will not amend its charter or by-laws to eliminate the requirements for two directors who are independent of the City. (Section 608)

Tobacco Settlement Revenues; City Covenant

The City has provided through the MSA, the Decree and the TSR Purchase Agreement for (a) TSASC's ownership and receipt of the TSRs, (b) the City's receipt of the net proceeds of the Tobacco Bonds (not including refunding Bonds) and (c) the resulting benefits to the people of the City and the State. Under the Indenture, TSASC acknowledges that the MSA, the Decree and the TSR Purchase Agreement constitute important security provisions of the Bonds and waives any right to assert any claim to the contrary and agrees that it will neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the City, the State or any other person of, any such claim to the contrary.

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

TSASC includes in the Indenture the City's pledge and agreement with the Holders of the Outstanding Bonds that the City will not limit or alter the rights of TSASC to fulfill the terms of its agreements with such Holders, or in any way impair the rights and remedies of such Holders or the security for such Bonds until such Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Holders, are fully paid and discharged. (Section 701)

No Indebtedness or Funds of City

The Indenture does not create indebtedness of the City for any purpose, including constitutional or statutory limitations. TSASC's revenues are not funds of the City. (Section 702)

Trustee's Organization, Authorization, Capacity and Responsibility

The Indenture Trustee represents and warrants under the Indenture that it is duly organized and validly existing under the laws of the State, having the powers of a trust company within the State, including the capacity to exercise the powers and duties of the Indenture Trustee under the Indenture, and that by proper corporate action it has duly authorized the execution and delivery of the Indenture.

The duties and responsibilities of the Indenture Trustee are as provided by law and as set forth in the Indenture. Notwithstanding the foregoing, no provision of the Indenture requires the Indenture Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, unless it receives indemnity satisfactory to it against any loss, liability or expense.

As Trustee under the Indenture:

(a) the Indenture Trustee may conclusively rely and will be fully protected in acting or refraining from acting upon any officer's certificate, opinion of Counsel (or both), resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper person or persons;

(b) before the Indenture Trustee acts or refrains from acting, it may require an officer's certificate or an opinion of Counsel. The Indenture Trustee will not be liable for any action it takes or omits to take in good faith in reliance on such certificate or opinion. Whenever the Indenture Trustee will deem it necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action, such matter (unless other evidence in respect thereof be specifically prescribed) may, in the absence of negligence or bad faith on the part of the Indenture Trustee, be deemed to be conclusively proved and established by an officers' certificate delivered to the Indenture Trustee, and such certificate, in the absence of negligence or bad faith on the part of the Indenture Trustee, will be full warrant to the Indenture Trustee for any action taken, suffered or omitted to be taken by it under the provisions of the Indenture upon the faith thereof;

(c) any request, direction, order or demand of TSASC mentioned in the Indenture will be sufficiently evidenced by an officers' certificate (unless other evidence in respect thereof be therein specifically prescribed); and any TSASC resolution may be evidenced to the Indenture Trustee by a copy thereof certified by the secretary or an assistant secretary of TSASC; and

(d) prior to the occurrence of an Event of Default, the Indenture Trustee will not be bound to make any investigation into the facts or matters stated in any resolution, certificate, officers' certificate, opinion of Counsel, TSASC resolution, statement, instrument, opinion, report, notice, request, consent, order, approval, appraisal, bond, debenture, note, coupon, security, or other paper or document unless requested in writing so to do by a Majority in Interest of the Senior Bonds affected and then Outstanding; and if the payment within a reasonable time to the Indenture Trustee of the costs, expenses or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Indenture Trustee, not reasonably assured to the Indenture Trustee by the security afforded to it by the terms of the Indenture, the Indenture Trustee may require indemnity satisfactory to it against such expenses or liabilities as a condition to proceeding. (Section 801)

Rights and Duties of the Fiduciaries

All money and investments received by the Fiduciaries under the Indenture will be held in trust, not commingled with any other funds, and applied solely pursuant to the provisions of the Indenture.

The Fiduciaries will keep proper accounts of their transactions under the Indenture (separate from its other accounts), which will be open to inspection on reasonable notice by TSASC and its representatives duly authorized in writing.

The Fiduciaries will not be required to monitor the financial condition of TSASC and, unless otherwise expressly provided, will not have any responsibility with respect to reports, notices, certificates or other documents filed with them under the Indenture, except to make them available for inspection by Beneficiaries.

Each Fiduciary will be entitled to the advice of counsel (who may be counsel for any party) and will not be liable for any action taken in good faith in reliance on such advice. Each Fiduciary may rely conclusively on any notice, certificate or other document furnished to it under the Indenture and reasonably believed by it to be genuine. A Fiduciary will not be liable for any action taken or omitted to be taken by it in good faith and reasonably believed by it to be within the discretion or power conferred upon it, or taken by it pursuant to any direction or instruction by which it is governed under the Indenture or omitted to be taken by it by reason of the lack of direction or instruction required for such action, or be responsible for the consequences of any error of judgment reasonably made by it.

The Fiduciaries will in no event be liable for the application or misapplication of funds, or for other acts or failures to act, by any person, firm or corporation except by their respective directors, officers, agents, and employees. No recourse will be had for any claim based on the Indenture, the Bonds, the Residual Certificate or any Swaps or Ancillary Contracts against any director, officer, agent or employee of any Fiduciary unless such claim is based upon the bad faith, fraud or deceit of such person.

Nothing in the Indenture will obligate any Fiduciary to pay any debt or meet any financial obligations to any person in relation to the Bonds, the Residual Certificate, Swaps or Ancillary Contracts except from money received for such purposes under the Indenture or from the exercise of the Indenture Trustee's rights thereunder.

The Fiduciaries may be or become the owners of or trade in the Bonds or enter into Swaps or Ancillary Contracts with the same rights as if they were not the Fiduciaries.

Unless otherwise specified by Series Supplement, the Fiduciaries will not be required to furnish any bond or surety.

TSASC will, as and only as an Operating Expense, indemnify and save each Fiduciary harmless against any expenses and liabilities (including reasonable legal fees and expenses) that it may incur in the exercise of its duties and that are not due to its negligence or bad faith.

Nothing in the Indenture shall relieve any Fiduciary of responsibility for its negligence, bad faith or willful misconduct.

Any fees, expenses, reimbursements or other charges which any Fiduciary may be entitled to receive from TSASC under the Indenture, if not otherwise paid, will be a first lien upon (but only upon) any funds held by the Indenture Trustee for payment of Operating Expenses. (Section 802)

Resignation or Removal of the Indenture Trustee

Under the Indenture, the Indenture Trustee may resign on not less than 30 days' written notice to TSASC, the Holders and Moody's. The Indenture Trustee will be removed if rated below investment grade (Baa3) by Moody's, and each successor Indenture Trustee will have an investment grade rating (Baa3 or higher) from Moody's. The Indenture Trustee may be removed by written notice from TSASC (if not in Default) or a Majority in Interest of the Outstanding Senior Bonds to the Indenture Trustee and TSASC. Such resignation or removal will not take effect until a successor has been appointed and has accepted the duties of Indenture Trustee. (Section 804)

Successor Fiduciaries

Any corporation or association which succeeds to the related corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation or otherwise, will thereby become vested with all the property, rights, powers and duties thereof under the Indenture, without any further act or conveyance.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary will with due care terminate its activities under the Indenture and a successor may, or in the case of the Indenture Trustee will, be appointed by TSASC. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with "—Resignation or Removal of the Indenture Trustee" above (Section 804 of the Indenture) or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor. Any successor Trustee appointed under this section will be a trust company or a bank having the powers of a trust company, located in the State, having a capital and surplus of not less than $50,000,000. (Section 805)

Fiduciaries for BANs or Subordinate Bonds

TSASC may by Series Supplement provide for the appointment of a Fiduciary (which may be the Indenture Trustee) to represent the Holders of BANs or Subordinate Bonds, having powers and duties not inconsistent herewith. (Section 806)

Trustee's Covenant

The Indenture Trustee will prepare and make available to all Holders semiannual statements of allocation of funds. (Section 807)

Action by Holders

Any request, authorization, direction, notice, consent, waiver or other action provided by the Indenture to be given or taken by Holders of Bonds may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Holders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, will be sufficient for any purpose of the Indenture (except as otherwise expressly provided) if made in the following manner, but TSASC or the Indenture 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 Holder or his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to TSASC or to the Indenture Trustee; or of any notary public or other officer authorized to take acknowledgements of deeds to be recorded in the jurisdiction in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the Holder of any Bond will be irrevocable and bind all future record and beneficial owners thereof. (Section 901)

Registered Owners

The enumeration of certain provisions applicable to DTC as Holder of immobilized Bonds will not be construed in limitation of the rights of TSASC and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Any payment to the registered owner of a Bond will satisfy TSASC's obligations thereon to the extent of such payment. (Section 902)

Remedies

Remedies of the Indenture Trustee. If an Event of Default occurs:

(a) The Indenture Trustee may, and upon written request of the Holders of 25% in principal amount of the Senior Bonds Outstanding will, in its own name by action or proceeding in accordance with the Civil Practice Law and Rules:

(1) enforce all rights of the Holders and require TSASC or, to the extent permitted by law, the City to carry out its agreements with the Holders and to perform its duties under the TSR Purchase Agreement;

(2) sue upon such Bonds;

(3) require TSASC to account as if it were the trustee of an express trust for the Holders of such Bonds; and

(4) enjoin any acts or things which may be unlawful or in violation of the rights of the Holders of such Bonds.

(b) The Indenture Trustee will, in addition to the other provisions of this section, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Holders in the enforcement and protection of their rights.

(c) Upon a Default of TSASC under clause (i) under the definition of "Event of Default" (Section 1001(a)(1) of the Indenture) or a failure actually known to an authorized officer of the Indenture Trustee to make any other payment required under the Indenture within 7 days after the same becomes due and payable, the Indenture Trustee will give written notice thereof to TSASC. The Indenture Trustee will give Default notices under clauses (ii) and (iv) under the definition of "Event of Default" (paragraphs (a) (2) and (b) of Section 1001 of the Indenture) when instructed to do so by the written direction of another Fiduciary or the owners of at least 25% in principal amount of the Outstanding Senior Bonds. The Indenture Trustee will proceed under the Indenture for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Senior Bonds. The Indenture Trustee will not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Indenture Trustee will promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Holders, and will act for the protection of the Holders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Extraordinary Prepayment. If an Event of Default occurs, the Outstanding Senior Bonds will be paid, in whole or in part, from all available funds in the Extraordinary Prepayment Account or the Trapping Account, pursuant to the provisions described in "Security—Flow of Funds" (Section 501(B) of the Indenture), at the principal amount thereof plus accrued interest to the date of payment.

Subordinate Bond Remedies. Subject to the prior application of the Accounts to pay Debt Service, to the immediately following paragraph (Section 1002(D) of the Indenture) and to each applicable Series Supplement, the Holders of BANs, Subordinate Bonds or the Holder of the Residual Certificate, or a Fiduciary appointed pursuant to "—Fiduciaries for BANs or Subordinate Bonds" above (Section 806 of the Indenture), may enforce the provisions of the Indenture for their benefit by appropriate legal proceedings.

Individual Remedies. No one or more Holders will by his or their action affect, disturb or prejudice the pledge created by the Indenture, or enforce any right under the Indenture, except in the manner provided in the Indenture; but nothing in the Indenture will affect or impair the right of any Holder of any Bond to enforce payment of the principal of, premium, if any, or interest thereon at and after the same comes due pursuant to the Indenture, or the obligation of TSASC to pay such principal, premium, if any, and interest on each of the Bonds to the respective Holders thereof at the time, place, from the source and in the manner expressed in the Indenture and the Bonds.

Venue. The venue of every action, suit or special proceeding against TSASC will be laid in the County of New York.

Waiver. If the Indenture Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Indenture Trustee may waive the Default and its consequences, by written notice to TSASC, and will do so upon written instruction of the Holders of at least 25% in principal amount of the Outstanding Senior Bonds. (Section 1002)

Supplements and Amendments to the Indenture

The Indenture may be:

(a) supplemented by delivery to the Indenture Trustee of an instrument certified by an authorized officer of TSASC to (1) provide for earlier or greater deposits into the Bond Fund, (2) subject any property to the lien of the Indenture, (3) add to the covenants and agreements of TSASC or surrender or limit any right or power of TSASC, (4) identify particular Bonds for purposes not inconsistent herewith, including credit or liquidity support, remarketing, serialization and defeasance, (5) cure any ambiguity or defect, (6) 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, or of the Indenture under the Trust Indenture Act of 1939, as amended, or (7) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Indenture, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds, or to modify or rescind any such authorization or determination at any time prior to the first authentication and delivery of such Series of Bonds (or BANs in anticipation thereof); or

(b) amended by TSASC and the Indenture Trustee, with the consent of the holder of the Residual Certificate, (1) to add provisions that are not materially adverse to the Holders, (2) to adopt amendments that do not take effect unless and until (A) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (B) such amendment is consented to by the Holders of such Bonds in accordance with the Indenture, or (3) pursuant to the following paragraph.

Except as provided in the foregoing paragraph, the Indenture may be amended:

(a) only with written notice to the Rating Agencies and the written consent of a Majority in Interest of the Subordinate Bonds, BANs and Senior Bonds (acting as separate classes) to be Outstanding at the effective date thereof and affected thereby; but

(b) only with the unanimous written consent of the affected Holders for any of the following purposes: (1) to extend the maturity, Principal Installment Payment Dates or Super Sinker Redemption Dates of any Bond, (2) to reduce the principal amount, applicable premium or interest rate of any Bond, (3) to make any Bond redeemable other than in accordance with its terms, (4) to create a preference or priority of any Bond over any other Bond of the same class or (5) to reduce the percentage of the Bonds required to be represented by the Holders giving their consent to any amendment.

Any amendment of the Indenture will be accompanied by an opinion of Counsel to the effect that the amendment is permitted by law and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for Federal income tax purposes.

When TSASC determines that the requisite number of consents have been obtained for an amendment to the Indenture or the TSR Purchase Agreement which requires consents, it will file a certificate to that effect in its records and give notice to the Indenture Trustee and the Holders. (Section 1101)

Supplements and Amendments to the TSR Purchase Agreement

In the event that the Indenture Trustee receives a request for a consent or other action under the TSR Purchase Agreement the Indenture Trustee may, and if consent or other action by Holders is required will, transmit a notice of such request to each Holder and request directions with respect thereto; and the Indenture Trustee (and TSASC, if applicable) will proceed in accordance with such directions (if any), the Indenture and the TSR Purchase Agreement. (Section 1102)

Definitions

In addition to terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

"**Accounts**" means the Collection Account, the Accounts in the Bond Fund and Accounts established by Series Supplement, which if providing for Junior Payments will be outside the Bond Fund; all of which shall be segregated trust accounts established and held by the Indenture Trustee.

"**Accreted Value**" means the voting power of a Bond for which Accreted Value is specified by Series Supplement; and has such further meaning and effect as may be specified in the Indenture.

"**Act**" means the Not-For-Profit Corporation Law of the State, as in effect from time to time.

"**Beneficiaries**" means Holders and, to the extent specified, the owner of the Residual Certificate and the parties to Swaps and Ancillary Contracts.

"**Bonds**" means all obligations issued as Bonds or BANs pursuant to Section 301.

"**Counsel**" means nationally recognized bond counsel or such other counsel as may be selected by TSASC for a specific purpose.

"**Coupon Bonds**" means coupon Bonds and Bonds registered to bearer.

"**Default**" means an Event of Default without regard to any declaration, notice or lapse of time.

"**Defeasance Collateral**" means money and (i) non-callable direct obligations of the United States of America, non-callable and non-prepayable direct federal agency obligations the timely payment of principal of and interest on which are fully and unconditionally guaranteed by the United States of America, non-callable direct obligations of the United States of America which have been stripped by the United States Treasury itself or by any Federal Reserve Bank (not including "CATS," "TIGRS" and "TRS" unless TSASC obtains Rating Confirmation with respect thereto) and the interest components of REFCORP bonds for which the underlying bond is non-callable (or non-callable before the due date of such interest component) for which separation of principal and interest is made by request to the Federal Reserve Bank of New York in book-entry form, and will exclude investments in mutual funds and unit investment trusts;

(ii) obligations timely maturing and bearing interest (but only to the extent that the full faith and credit of the United States of America are pledged to the timely payment thereof);

(iii) certificates evidencing ownership of the right to the payment of the principal of or interest on obligations described in clause (ii), provided that such obligations are held in the custody of a bank or trust company satisfactory to the Indenture Trustee in a segregated trust account in the trust department separate from the general assets of such custodian; and

(iv) bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state (x) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, and (y) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii) or (iii) which fund may be applied only to the payment when due of such bonds or other obligations.

"**Defeased Bonds**" means Bonds that remain in the hands of their Holders but are no longer deemed Outstanding. When a Senior Bond is to be defeased, TSASC will provide for payment of its principal on or before its Super Sinker Redemption Date or, if the Super Sinker Redemption Date has passed, not later than the next Distribution Date for which any required notice of redemption can be timely given.

"**Deposit Date**" means a date no later than 5 Business Days following each deposit of Revenues in the Collection Account.

"**Eligible Investments**" means:

(i) Defeasance Collateral;

(ii) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, FNMA or the Federal Farm Credit System;

(iii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association or savings bank, payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated A-1+ by S&P and P-1 by Moody's;

(iv) general obligations of, or obligations guaranteed by, any state of the United States or the District of Columbia rated at least Aa1 by Moody's and receiving one of the two highest long-term unsecured debt ratings available for such securities from S&P;

(v) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than three months after the date of issuance thereof) that is rated A-1+ by S&P and P-1 by Moody's;

(vi) repurchase obligations with respect to any security described in clause (i) or (ii) above entered into with a primary dealer, depository institution or trust company (acting as principal) rated A-1+ by S&P and P-1 by Moody's (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated at least Aa1 by Moody's and in one of the two highest long-term rating categories by S&P, or collateralized in accordance with the Indenture;

(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 P-1 by Moody's and A-1+ by S&P at the time of such investment or contractual commitment providing for such investment; *provided*, *however,* 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 money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated at least Aa1 by Moody's and at least AAm or AAm-G by S&P, including if so rated any such fund which the Indenture Trustee or an affiliate of the Indenture Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (x) the Indenture Trustee or an affiliate of the Indenture Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (y) the Indenture Trustee charges and collects fees and expenses for services rendered pursuant to the Indenture, and (z) services performed for such funds and pursuant to the Indenture may converge at any time (TSASC specifically authorizes the Indenture Trustee or an affiliate of the Indenture Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Indenture Trustee may charge and collect for services rendered pursuant to the Indenture);

(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, at least Aa1 by Moody's and in one of the two highest long-term rating categories by S&P if TSASC has an option to terminate such agreement in the event that either such rating is downgraded below the rating on the Senior Bonds, or collateralized in accordance with the Indenture; and

(x) other obligations or securities that are non-callable and that are acceptable to each Rating Agency;

provided that no Eligible Investment may (a) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument or (b) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity.

"**FHLMC**" means the Federal Home Loan Mortgage Corporation.

"**Fiduciary**" means the Indenture Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent.

"**FNMA**" means the Federal National Mortgage Association.

"**Holders**" mean the registered owners of the Bonds from time to time as shown on the books of TSASC, and to the extent specified by Series Supplement, the owners of Coupon Bonds.

"**Majority in Interest**" means the Holders of a majority of the Outstanding Bonds eligible to act on a matter, measured by face value at maturity or by Accreted Value as specified in a Series Supplement.

"**Local Law**" means Local Law No, 31 of the City, enacted June 7, 1999.

"**Operating Expenses**" means all expenses incurred by TSASC in the administration of TSASC including but not limited to arbitrage rebate and penalties, salaries, administrative expenses, insurance premiums, auditing and legal expenses, fees and expenses incurred for professional consultants and fiduciaries, and all Operating Expenses so identified in the Indenture.

"**Other Series**" of Bonds means Series thereof other than the Series 2002-1 Bonds.

"**Outstanding Bonds**" means Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Indenture Trustee for credit against a principal payment; (ii) Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them; and any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Indenture Trustee; (v) Bonds the payment of which will have been provided for pursuant to "—Defeasance" above (Section 202 of the Indenture); and (vi) for purposes of any consent or other action to be taken by the Holders of a Majority in Interest or specified percentage of Bonds, Bonds held by or for the account of TSASC, the City or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, "control," when used with respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"**Permitted Indebtedness**" means Bonds, the Residual Certificate and borrowings to pay Operating Expenses (as described in Section 601(b) of the Indenture).

"**Rated Swap**" means a Swap Contract if the counterparty is limited to entities (1) the debt securities of which are rated in one of the two highest long-term debt rating categories by Moody's and S&P or (2) the obligations of which under the contract are either so rated or guaranteed or insured by an entity the debt securities or insurance policies of which are so rated or (3) the debt securities of which are rated in the third highest long-term debt rating category by Moody's and S&P or whose obligations are guaranteed or insured by an entity so rated, in either case the obligations of which under the contract are continuously and fully secured by Eligible Investments meeting criteria provided by Moody's and S&P to TSASC and then in effect.

"**Revenues**" means the TSRs and all aid, rents, fees, charges, payments, investment earnings and other income and receipts (including Bond proceeds but only to the extent deposited in an Account) paid or payable to TSASC or the Indenture Trustee for the account of TSASC or the Beneficiaries.

"**Tax-Exempt Bonds**" means all Bonds so identified in any Series Supplement, including the Series 2002-1 Bonds.

THE TSR PURCHASE AGREEMENT

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

Conveyance of Tobacco Assets

In consideration of TSASC's delivery to or upon the order of the City of the Ownership Interest and the net proceeds (after Financing Costs and capitalized interest) of the Series 1999-1 Bonds, the City has sold, transferred, assigned, set over and otherwise conveyed to TSASC, without recourse (subject to the obligations in the TSR Purchase Agreement), all right, title and interest of the City in and to the Tobacco Assets. (Section 2.01)

Representations of the City

The City made the following representations to TSASC in the TSR Purchase Agreement, on which TSASC relied in acquiring the Tobacco Assets. The representations survive the sale of the Tobacco Assets to TSASC and the pledge thereof to the Indenture Trustee pursuant to the Indenture.

Power and Authority. The City is validly existing as a municipal corporation under the laws of the State, including the Constitution of the State, with full power and authority to execute and deliver the TSR Purchase Agreement and to carry out its terms; the City has full power, authority and legal right to sell and assign the Tobacco Assets to TSASC and has authorized such sale and assignment to TSASC by all necessary action; and the execution, delivery and performance of the TSR Purchase Agreement has been duly authorized by the City.

Binding Obligation. The TSR Purchase Agreement has been duly executed and delivered by the City and, assuming the due authorization, execution and delivery of the TSR Purchase Agreement by TSASC, constitutes a legal, valid and binding obligation of the City enforceable in accordance with its terms.

No Consents. No consent, approval, authorization, order, registration or qualification of or with any court or governmental agency or body is required for the consummation of the transactions contemplated by the TSR Purchase Agreement, except for those which have been obtained and are in full force and effect.

No Violation. The consummation by the City of the transactions contemplated by the Transaction Documents and the fulfillment of the terms thereof do not, to the City's knowledge, in any material way conflict with, result in any material breach of any of the material terms and provisions of, nor constitute (with or without notice of lapse of time) a material default under any indenture, the TSR Purchase Agreement or other instrument to which the City is a party or by which it shall be bound; nor violate any law or, to the City's knowledge, any order, rule or regulation applicable to the city of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the City.

No Proceedings. To the City's knowledge, except as disclosed in the TSR Purchase Agreement or in a schedule delivered to TSASC, there are no material proceedings or investigations pending against the City, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the City: (i) asserting the invalidity of any of the Transaction Documents or the Bonds, (ii) seeking to prevent the issuance of the Bonds or the consummation of any of the transactions contemplated by any of the Transaction Documents, or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of any of the Transaction Documents or the Bonds.

Title to Tobacco Assets. The City was the sole owner of the Tobacco Assets immediately prior to their sale to TSASC.

Absence of Liens on Tobacco Assets. The City sold the Tobacco Assets free and clear of any and all liens, pledges, charges, security interests or any other statutory impediments to transfer of any nature encumbering the Tobacco Assets.

The City acknowledges that TSASC assigned to the Indenture Trustee for the benefit of the Bondholders all of its rights and remedies with respect to the breach of any representations and warranties of the City under the TSR Purchase Agreement.

Upon discovery by the City, TSASC or a Responsible Officer of the Indenture Trustee of a breach of any of the foregoing representations and warranties that materially and adversely affects the value of the Tobacco Assets, the party discovering such breach will give prompt written notice to the other parties. The City will not be liable to the Indenture Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Indenture Trustee to promptly notify the City upon the discovery by a Responsible Officer of the Indenture Trustee of a breach of any such representation or warranty. (Section 3.01)

Limitation on Liability

The City and any officer or employee or agent of the City 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 hereunder. The City will not be under any obligation to appear in, prosecute or defend any legal action that will not be related to its obligations under the TSR Purchase Agreement, and that in its opinion may involve it in any expense or liability. Neither the City nor any of the officers or employees or agents of the City will be under any liability to TSASC, except as provided under the TSR Purchase Agreement, for any action taken or for refraining from the taking of any action pursuant to the TSR Purchase Agreement or for errors in judgment; but this sentence will not protect the City or any such person against any liability that would otherwise be imposed by reason of willful misfeasance, bad faith or negligence in the performance of its duties or by reason of reckless disregard of obligations and duties under the TSR Purchase Agreement. (Section 3.03)

Protection of Title; Non-Impairment Covenant

The City will take all actions as may be required by law fully to preserve, maintain, defend, protect and confirm the interest of TSASC and the interests of the Indenture Trustee on behalf of the Bondholders in the Tobacco Assets and in the proceeds thereof. The City will not take any action that will adversely affect TSASC's ability to receive payments made under the MSA and the Decree. Under the TSR Purchase Agreement, the City will pledge and agree with TSASC and the Bondholders, that the City will not limit or alter the rights of TSASC to fulfill the terms of its agreements with such Bondholders, or in any way impair the rights and remedies of such Bondholders or the security for the Bonds until the Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Bondholders, are fully paid and discharged. (Section 4.01)

Protection of Decree and MSA

The City will not take any action and will use its best reasonable efforts not to permit any action to be taken by others that would release any person from any of such person's covenants or obligations under the Decree and the MSA or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the Decree or the MSA, nor, without the prior written consent of TSASC and the Indenture Trustee on behalf of the Bondholders, amend, modify, terminate, waive, or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the Decree or the TSR Purchase Agreement, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Bondholders. (Section 4.02)

Further Actions

Upon request of TSASC or the Indenture Trustee, the City will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of the TSR Purchase Agreement. The City will promptly pay over to the Indenture Trustee the proceeds of any Tobacco Assets received by the City in error. (Section 4.03)

Tax Covenant

The City will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by TSASC on Tax-Exempt Bonds will be excludable from gross income for Federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the City will at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations thereunder. (Section 4.04)

Amendment

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

Except as otherwise provided in the preceding paragraph, the TSR Purchase Agreement may also be amended from time to time by the City and TSASC with the consent of the Indenture Trustee and Rating Confirmation or the consent of a Majority in Interest of the Senior Bonds for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the TSR Purchase Agreement or of modifying in any manner the rights of the Bondholders; but no such amendment shall reduce the aforesaid portion of the outstanding amount of the Senior Bonds, the Holders of which are required to consent to any such amendment, without the consent of the Holders of all the outstanding Senior Bonds. (Section 5.01)

Assignment by TSASC

The City has acknowledged and consented to the pledge, assignment and grant of a security interest by TSASC to the Indenture Trustee pursuant to the Indenture for the benefit of the Bondholders of any and all right, title and interest of TSASC in, to and under the Tobacco Assets and the assignment of any or all of TSASC's rights and obligations thereunder to the Indenture Trustee. (Section 5.10)

Nonpetition Covenant

The City shall not, prior to the date which is one year and one day after the termination of the TSR Purchase Agreement, acquiesce, petition or otherwise invoke or cause TSASC or the Residual Trust to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against TSASC or the Residual Trust under any Federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of TSASC or the Residual Trust or any substantial part of its property, or ordering the winding up or liquidation of the affairs of TSASC or the Residual Trust. (Section 5.11)

Limitation of Liability of the City

Notwithstanding anything in the TSR Purchase Agreement to the contrary, no officer or employee of the City will have any liability for the representations, warranties, covenants, agreements or other obligations of the City in the TSR Purchase Agreement or in any of the certificates, notices or documents delivered pursuant to the TSR Purchase Agreement, as to all of which recourse will be had solely to the assets of the City. (Section 5.12)

Definitions

In addition to terms defined elsewhere herein, the following terms have the following meanings in this summary, unless the context otherwise requires:

"**Financing Costs**" means all costs, fees, reserves and credit and liquidity enhancements as TSASC determines to be desirable in issuing, securing and marketing the Tobacco Bonds.

"**Lien**" means a security interest, lien, charge, pledge, equity or encumbrance of any kind, attaching to the interests of the City in and to the Tobacco Assets, whether or not as a result of any act or omission by the City.

"**Opinion of Counsel**" means one or more written opinions of counsel who may be an employee of or counsel to the City, which counsel is acceptable to the Indenture Trustee.

"**Ownership Interest**" means the undivided beneficial interest of the Trust created by the Trust Agreement.

"**Residual Trust**" or "**Trust**" means TSASC Tobacco Settlement Trust, the trust established by TSASC pursuant to the Trust Agreement and which, as a result of its ownership of the Residual Certificate, is entitled to receive (i) the net proceeds of the Tobacco Bonds other than the Series 1999-1 Bonds and (ii) the revenues of TSASC that are in excess of TSASC's expenses, debt service and contractual obligations pursuant to the Indenture.

"**Tobacco Assets**" means all future right, title and interest of the City under the MSA and the Decree, including the rights of the City to receive, and to enforce the payment of, the money due to it under the Decree.

"**Tobacco Bonds**" means the bonds, notes and other obligations issued by TSASC under the Indenture (exclusive of bonds that TSASC may issue to refund bonds of TSASC), the net proceeds (after Financing Costs and capitalized interest) of which shall be used by TSASC to pay (directly or indirectly) a portion of the purchase price to the City for the Tobacco Assets.

"**Transaction Documents**" means the TSR Purchase Agreement, the Indenture and the Trust Agreement.

"**Trust Agreement**" means the Declaration and Agreement of Trust relating to the Residual Trust by and between the Trustee and TSASC, dated as of November 1, 1999, as such TSR Purchase Agreement may be amended and restated pursuant to the provisions thereof. (Section 1.01)

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal problems that could affect the Series 2002-1 Bonds and the other Program Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the TSRs to be reduced or eliminated. References in the discussion to various opinions of Transaction Counsel are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM

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

The description of the risks associated with the bankruptcy of a PM set forth below (which is not all-inclusive) assumes that the PM is a debtor in a reorganization case under Chapter 11 of the Bankruptcy Code. If a PM becomes bankrupt and is not a debtor in a Chapter 11 case, it would be liquidated under Chapter 7 of the Bankruptcy Code, in which event its operations would cease and its assets would be sold. In such an event, there would likely be a significant reduction in the amount of the TSRs actually received from the PM that is in the Chapter 7 case. To the extent that the volume of cigarettes sold by other PMs increased as a result of the cessation of operations by the PM being liquidated under Chapter 7 of the Bankruptcy Code, the market share of such other PMs would increase, and total TSRs would not be reduced.

Should a PM become a debtor in a bankruptcy case, the PM may be required to obtain bankruptcy court approval prior to making payments owed by it under the MSA. Legal proceedings necessary to resolve the issue regarding whether the PM's obligations under the MSA are operating expenses under the Bankruptcy Code or are otherwise authorized to be paid during the pendency of the bankruptcy proceedings could be time consuming and could result in delays in payments by the bankrupt PM.

MSA as Executory Contract. The treatment of the MSA under the Bankruptcy Code may be dependent upon whether the MSA is construed to be an executory contract (which is not defined by the Bankruptcy Code but generally is considered to be one in which performance remains due to some extent on both sides). Under the Bankruptcy Code, if the MSA is treated as an executory contract, a bankruptcy trustee (or a PM acting as a debtor-in-possession) would have the right to assume or reject the MSA. However, in a Chapter 11 case there is no time period within which a bankruptcy trustee (or a PM acting as debtor-in-possession) would be required to assume or reject the MSA. Legal proceedings necessary to resolve the issue regarding whether the MSA is an executory contract under the Bankruptcy Code could be time consuming and could result in delays in payments by the bankrupt PM.

Transaction Counsel will render an opinion to TSASC 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 court exercising federal bankruptcy jurisdiction, the court would hold that the MSA is an "executory contract" under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws, regulations, rulings and court decisions, and will cover 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 payments on the Series 2002-1 Bonds.

Assumption or Rejection of MSA. Should a bankruptcy trustee (or a PM acting as a debtor-in-possession) determine to assume the MSA, the bankruptcy trustee (or a PM acting as debtor-in-possession) must cure all outstanding MSA payment defaults or provide "adequate assurance" that such defaults would be cured promptly. "Adequate assurance" is not defined in the Bankruptcy Code and is determined by the bankruptcy court. Thus, the assurance provided by the bankrupt PM may be less than the assurance parties to a contract would require outside of bankruptcy and could result in delays in payments by the bankrupt PM.

In the event a bankruptcy trustee (or a PM acting as a debtor-in-possession) determines to reject the MSA, TSASC (and, thus, the Indenture Trustee and the Bondholders, as collateral assignees) may then have an unsecured, nonpriority claim for damages. Rejection of an executory contract should be treated as a breach of the contract by the PM. However, under the Bankruptcy Code, TSASC (and, thus, the Indenture Trustee and the Bondholders) nevertheless may be enjoined from commencing or continuing any action against the PM in order to enforce its remedies under the MSA (including an action to collect payments due under the MSA). In addition, because amounts owed by the PM under the MSA are not fixed, legal proceedings may be necessary to quantify the claims of TSASC (and, thus, the Indenture Trustee and the Bondholders) for damages as a result of the PM's rejection of the MSA. Such legal proceedings could be time consuming and could result in delays in payments by the bankrupt PM.

Modification of MSA Obligations. If the MSA is not construed to be an "executory contract" or if the PM determines to reject the MSA or if the PM is otherwise not authorized to make payments under the MSA, then a bankruptcy of the PM could result in long delays and possibly in large reductions in the amount of TSRs available to pay the Bondholders because under the Bankruptcy Code, the obligations of the PM under the MSA could be modified. For example, the bankruptcy court may approve a plan of reorganization or liquidation of the PM which alters the timing or the amount of payments to be made by the PM in respect of the MSA of a claim in favor of TSASC (and, thus, the Indenture Trustee and Bondholders).

Bankruptcy of the City

True Sale. If the City were to become a debtor under the Bankruptcy Code or other similar federal or state laws, a creditor or the City might argue that the transfer by the City of the TSRs to TSASC was (or should be recharacterized as) a pledge of the TSRs to secure a borrowing, rather than a true sale. A determination that such transfer was a secured borrowing and not a sale would invalidate the Bonds because the City is not authorized to make a secured borrowing. The City has warranted to TSASC that the sale by it of the TSRs to TSASC will be a true sale of the TSRs to TSASC. In addition, the City and TSASC have treated, and will treat, the transactions described in the TSR Purchase Agreement as a true sale and will take all actions that are required by the TSR Purchase Agreement to evidence such true sale.

Transaction Counsel will also render an opinion to TSASC, subject to all the facts, assumptions and qualifications stated therein, that, in a properly presented and argued case, there being no precedent directly on point, a court of competent jurisdiction would hold that in the event of a bankruptcy filing by the City, the TSRs sold by the City to TSASC would not be characterized as property of the City that would be available to the City's creditors. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws, regulations, rulings and court decisions, and will cover 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 TSRs sold by the City to TSASC would not be characterized as property of the City that would be available to the City's creditors, thus resulting in delays or reductions in payments on the Series 2002-1 Bonds.

Non-Consolidation. In the event of a bankruptcy or insolvency proceeding with respect to the City, a court could determine that the assets and liabilities of TSASC should be consolidated with those of the City. TSASC and the City have taken and will take steps that are intended to ensure that a voluntary petition for relief by the City under the Bankruptcy Code or similar applicable federal or state laws will not result in the substantive consolidation of the assets and liabilities of TSASC and the City.

Transaction Counsel will also render an opinion to TSASC, subject to all the facts, assumptions and qualifications stated therein, that in a properly presented and argued case, there being no precedent directly on point, a court of competent jurisdiction would not, over the objection of the Bondholders, substantively consolidate the assets and liabilities of TSASC with those of the City. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Transaction Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws, regulations, rulings and court decisions, and will cover matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that if the City were to become a debtor in a bankruptcy case, a court would not order that the assets and liabilities TSASC be consolidated with those of the City, thus resulting in delays or reductions in payments on the Series 2002-1 Bonds.

Actions could be taken in a bankruptcy of the City which would adversely affect the exclusion of interest on the Series 2002-1 Bonds from gross income for federal income tax purposes. There may be other possible effects of bankruptcy of the City that could result in delays or reductions in payments to the holders of the Series 2002-1 Bonds.

Regardless of any specific adverse determinations in a City bankruptcy proceeding, the fact of a City bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2002-1 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 and the OPMs are 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.

Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, certain of 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 and/or a determination that the MSA is void or unenforceable. By way of example, and not by limitation, in *Bedell Wholesale Co. v. Philip Morris*, certain SPMs and NPMs brought an action against the OPMs alleging that certain sections of the MSA violated the Sherman Antitrust Act. The District Court dismissed the case holding that the OPMs were immune from antitrust liability under both the Noerr-Pennington ("**NP**") and Parker immunity doctrines. The Court of Appeals on June 19, 2001, affirmed the District Court's dismissal of the case. The Court of Appeals held that defendants were immune from antitrust liability under the NP doctrine but not under the Parker immunity doctrine. The Court of Appeals had earlier explained that in reviewing the District Court's decision, it would have to affirm the dismissal if the OPMs were immune under either the NP doctrine or the Parker immunity doctrine. In July 2001, the SPMs and NPMs filed a request for an *en banc* hearing before the Third Circuit, which request was denied. Attorneys for Bedell filed a petition for a writ of certiorari in the U.S. Supreme Court on October 19, 2001. On January 7, 2002, the U.S. Supreme Court denied the petition.

On October 31, 2001, the same attorneys representing Bedell filed a lawsuit in a Pennsylvania federal district court against two state officials (*Mariana, et al. v. D. Michael Fisher, in his official capacity as Attorney General of the Commonwealth of Pennsylvania, et al.*) seeking to enjoin the State of Pennsylvania from receiving moneys payable to it under the MSA, alleging that the MSA violates federal antitrust laws and certain provisions of the United States Constitution. On June 17, 2002, the court dismissed the case. The plaintiff has appealed.

Legal enforcement of the terms of the MSA may continue to be challenged in the future. To date, no such lawsuits have been successful. 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, the Owners could incur a complete loss of their investment. See "RISK FACTORS—Limited Remedies" herein.

After having considered the effect of the above-referenced actions, and subject to the assumptions and qualifications set forth below, Transaction Counsel will render an opinion to TSASC that the MSA is a valid, binding and enforceable obligation of the signatories thereto under New York law. The opinion of Transaction Counsel as to the enforceability of the MSA and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar laws affecting the rights and remedies of creditors generally and to the effect of general principles of equity, whether applied by a court of law or equity.

In rendering its enforceability opinion with respect to the MSA, Transaction Counsel has assumed (i) the due organization and valid existence of each signatory to the MSA, (ii) the due authorization, execution and delivery of the MSA by each such signatory (other than the State) and its full power, authority and legal right to execute and to deliver, and to perform and observe the provisions of, the MSA, (iii) that the execution, delivery and performance by each such signatory of the MSA does not (1) violate the provisions of the organizational documents of such signatory, (2) violate any judgment, decree, writ, injunction, award, determination or order applicable to any such signatory, or (3) conflict with, or result in a breach of, or constitute a default under, any of the provisions of any indenture, mortgage, deed of trust, contract or other instrument to which such signatory is a party, and (iv) the absence of the need for any consent, approval, order or authorization of, or filing with or notice to, any court or other governmental authority in respect of each such signatory that was not obtained.

Model Statute Constitutionality

Two cases which challenged the enforceability of the MSA also challenged the Model Statute, although, as described herein, one of such cases has been dismissed with prejudice. Other cases have also challenged the Model Statute as part of an antitrust theory. On August 13, 1999, in *PTI, Inc., et al. v. Philip Morris Inc., et al.*, certain cigarette importers and cigarette distributors filed an action in the United States 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 Model Statute 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 Model Statute (termed by the plaintiffs and the district court as the "Qualifying Statute"). The complaint alleged, among other things, that the passage, implementation and/or enforcement of the Model Statute would violate federal antitrust laws and certain provisions of the United States 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, but dismissed with prejudice all federal antitrust and constitutional claims against the PMs and the California State Defendants based on the merits. On December 15, 2000, in *Star Scientific*, a cigarette manufacturer filed an action in the United States District Court of the Eastern District of Virginia. The plaintiff manufacturer, making many of the same constitutional arguments made in the *PTI* case by the plaintiff importers and distributors, seeks, among other things, to enjoin the enforcement of the Virginia Model Statute. The *Star Scientific* case has been dismissed by the trial court. On January 22, 2002 the Fourth Circuit Court of Appeals affirmed the order dismissing the case. The plaintiff has filed a petition for a writ of certiorari in the U.S. Supreme Court. On July 24, 2001 *North American Trading Company and International Tobacco Partners, LLC v. "NAAG" et al.* ("*North American*"), was filed in the United States District Court for the District of Columbia. In this case, the plaintiff, an importer of foreign-made cigarettes, has alleged that importers or wholesalers of foreign-made cigarettes intended for resale in the United States are not Tobacco Product Manufacturers as defined in the Model Statute and have no substantial nexus to a particular state. Plaintiffs requested an injunction to prevent the enforcement of the application of the Model Statute against them. On September 18, 2001, the District Court dismissed the case, and the plaintiffs have appealed. On July 1, 2002 *Grand River Enterprises Six Nations, Ltd. et al. v. William Pryor et al.* ("Grand River") was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the Model Statutes, including the New York Model Statute, violate their constitutional rights under the First and Fourteenth Amendments and the Commerce Clause of the United States Constitution and violate the Sherman Act on antitrust grounds. No argument has yet been scheduled.

Although a determination that the Model 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. See "RISK FACTORS—Risks Related to Enforceability or Modification of the MSA and Constitutionality of the Model Statute—*Qualifying Statute*" herein.

After having considered the effect of the above-referenced actions 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 Model Statute would advance in an attempt to invalidate the Model Statute, and subject to the assumptions and qualifications set forth below, Transaction Counsel will render an opinion to TSASC that the State's Model Statute is valid and enforceable.

In rendering its enforceability opinion with respect to the State's Model Statute, Transaction Counsel has assumed enforceability may be affected by bankruptcy, insolvency and other laws affecting creditors' rights or remedies heretofore or hereafter enacted, and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law). In rendering its enforceability opinion with respect to the State's Model Statute, Transaction Counsel will rely without investigation upon a letter from counsel to the OPMs confirming that the OPMs would not dispute that the State's Model Statute, if maintained in its current form without modification or addition, is a Model Statute with the meaning of the MSA.

Limitations on Certain Opinions of Transaction Counsel

The opinions of Transaction Counsel described above expressly note that a court's decision regarding the matters upon which Transaction Counsel 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, for example, a conclusion by such a court that the MSA is void or voidable would not necessarily constitute reversible error. Consequently, an opinion of Transaction 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 Transaction 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, but rather reflects the informed professional judgment of Transaction Counsel.

Impairment of Contracts

Although the MSA Escrow Agent has been instructed to pay the TSRs to the Indenture Trustee, it is possible that the State could in the future attempt to claim some or all the TSRs for itself or otherwise interfere with the security for the Bonds. In that event the Bondholders could assert constitutional claims, including claims under the State and federal Due Process Clauses and the federal Contracts Clause.

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

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

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

No Assurance as to the Outcome of Litigation of Contracts

With respect to all matters of litigation mentioned above that have been brought and may in the future be brought against the PMs, or involving the enforceability of the MSA or constitutionality of the Model 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 payment of principal of and interest on the Series 2002-1 Bonds.

CONTINUING DISCLOSURE UNDERTAKING

To the extent that Rule 15c2-12 (the "**Rule**") of the Securities and Exchange Commission (the "**SEC**") promulgated under the Securities Exchange Act of 1934, as amended (the "**1934 Act**"), requires the Underwriters to determine, as a condition to purchasing the Series 2002-1 Bonds, that TSASC will make such covenants, TSASC will covenant for the sole benefit of the Bondholders as follows:

TSASC shall provide (a) within 350 days after the end of each fiscal year, to each nationally recognized municipal securities information repository and to any State information depository, core financial information and operating data for the prior fiscal year, including (i) TSASC's audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, and (ii) material historical quantitative data on TSASC's revenues, expenditures, financial operations and indebtedness generally of the types discussed in "SUMMARY OF BOND STRUCTURING ASSUMPTIONS AND AMORTIZATION" under the last column in the table captioned "Projection of Total Payments to be Received by TSASC"; and also the debt service coverage for the most recent full Fiscal Year for all Series of Outstanding Senior Bonds based on Principal Installments and Super Sinker Redemptions.

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

(1) principal and interest payment delinquencies;

(2) non-payment related defaults;

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

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

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

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

(7) modifications to rights of Bondholders;

(8) bond calls;

(9) defeasances;

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

(11) rating changes; and

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

TSASC will not undertake to provide any notice with respect to (i) credit enhancement if the credit enhancement is added after the primary offering of the Series 2002-1 Bonds, TSASC does not apply for or participate in obtaining the enhancement and the enhancement is not described in this Offering Circular or (ii) tax exemption other than pursuant to Section 103 of the Code.

TSASC will not undertake to provide the above-described event notice of a mandatory scheduled redemption, not otherwise contingent upon the occurrence of an event, if (i) the terms, dates and amounts of redemption are set forth in detail herein, (ii) the only open issue is which Series 2002-1 Bonds will be redeemed in the case of a partial redemption, (iii) notice of redemption is given to the Bondholders as required under the terms of the Series 2002-1 Bonds and (iv) public notice of the redemption is given pursuant to 1934 Act Release No. 23856 of the SEC, even if the originally scheduled amounts are reduced by prior optional redemptions or Series 2002-1 Bond purchases.

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

No Bondholder may institute any suit, action or proceeding at law or in equity ("**Proceeding**") for the enforcement of the continuing disclosure undertaking (the "**Undertaking**") or for any remedy for breach thereof, unless such Bondholder shall have filed with TSASC evidence of ownership and a written notice of and request to cure such breach, and TSASC shall have refused to comply within a reasonable time. All Proceedings shall be instituted only as specified herein, in the federal or state courts located in the Borough of Manhattan, State and City of New York, and for the equal benefit of all holders of the outstanding bonds benefited by the same or a substantially similar covenant, and no remedy shall be sought or granted other than specific performance of the covenant at issue.

An amendment to the Undertaking may only take effect if:

(a) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of TSASC, or type of business conducted; the Undertaking, as amended, would have complied with the requirements of the Rule at the time of sale of a series of Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and the amendment does not materially impair the interests of Bondholders, as determined by parties unaffiliated with TSASC (such as, but without limitation, TSASC's financial advisor or bond counsel) and the annual financial information containing (if applicable) the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the "impact" (as that word is used in the letter from the SEC staff to the National Association of Bond Lawyers dated June 23, 1995) of the change in the type of operating data or financial information being provided; or

(b) all or any part of the Rule, as interpreted by the staff of the SEC at the date of the Series 2002-1 Bonds, ceases to be in effect for any reason, and TSASC elects that the Undertaking shall be deemed terminated or amended (as the case may be) accordingly.

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

TAX EXEMPTION AND OTHER TAX MATTERS

In the opinion of Sidley Austin Brown & Wood LLP, New York, New York, as Transaction Counsel, except as provided in the following sentence, interest on the Series 2002-1 Bonds will not be includable in the gross income of the owners of the Series 2002-1 Bonds for purposes of federal, New York State or New York City income taxation under existing law. Interest on the Series 2002-1 Bonds will be includable in the gross income of the owners thereof retroactive to the date of issue of the Series 2002-1 Bonds in the event of a failure by TSASC or the City to comply with applicable requirements of the Code, and covenants regarding use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the United States Treasury, and no opinion is rendered by Sidley Austin Brown & Wood LLP as to the exclusion from gross income of the interest on the Series 2002-1 Bonds on or after the date on which any action is taken under the Bonds proceedings upon the approval of counsel other than such firm.

Interest on the Series 2002-1 Bonds will not be a specific preference item for purposes of the federal individual or corporate alternative minimum tax. The Code contain other provisions that could result in tax consequences, upon which Sidley Austin Brown & Wood LLP renders no opinion, as a result of ownership of the Series 2002-1 Bonds or the inclusion in certain computations (including, without limitation, those related to the corporate alternative minimum tax) of interest that is excluded from gross income. Interest on the Series 2002-1 Bonds owned by a corporation will be included in the calculation of the corporation's federal alternative minimum tax liability.

Ownership of tax-exempt obligations may result in collateral tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S Corporations with excess passive income, individual recipients of Social Security or railroad retirement benefits, taxpayers eligible for the earned income tax credit and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations. Prospective purchasers of the Series 2002-1 Bonds should consult their tax advisors as to the applicability of any such collateral consequences.

The excess, if any, of the amount payable at maturity of any maturity of the Series 2002-1 Bonds purchased as part of the initial public offering over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any maturity of the Series 2002-1 Bonds with original issue discount (a "Discount Bond") will be excluded from gross income for Federal, State and City income tax purposes to the same extent as interest on the Series 2002-1 Bonds. In general, the issue price of a maturity of the Series 2002-1 Bonds is the first price at which a substantial amount of Series 2002-1 Bonds of that maturity was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers) and the amount of original issue discount accrues in accordance with a constant yield method based on the compounding of interest. A purchaser's adjusted basis in a Discount Bond is to be increased by the amount of such accruing discount for purposes of determining taxable gain or loss on the sale or other disposition of such Discount Bonds for Federal income tax purposes. A portion of the original issue discount that accrues in each year to an owner of a Discount Bond which is a corporation will be included in the calculation of the corporation's Federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to an owner of a Discount Bond is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral Federal income tax consequences discussed above. Consequently, owners of any Discount Bond should aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral Federal income tax consequences although the owner of such Discount Bond has not received cash attributable to such original issue discount in such year.

The accrual of original issue discount and its effect on the redemption, sale or other disposition of a Discount Bond that is not purchased in the initial offering at the first price at which a substantial amount of such Bonds is sold to the public may be determined according to rules that differ from those described above. An owner of a Discount Bond should consult his tax advisors with respect to the determination for Federal income tax purposes of the amount of original issue discount with respect to such Discount Bond and with respect to state and local tax consequences of owning and disposing of such Discount Bond.

The excess, if any, of the tax basis of the Series 2002-1 Bonds purchased as part of the initial public offering to a purchaser (other than a purchaser who holds such Series 2002-1 Bonds as inventory, stock in trade or for sale to customers in the ordinary course of business) over the amount payable at maturity is "bond premium." Bond premium is amortized over the term of such Series 2002-1 Bonds for Federal income tax purposes (or, in the case of a bond with bond premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). Owners of such Series 2002-1 Bonds are required to decrease their adjusted basis in such Series 2002-1 Bonds by the amount of amortizable bond premium attributable to each taxable year such Series 2002-1 Bonds are held. The amortization bond premium on such Series 2002-1 Bonds attributable to a taxable year is not deductible for Federal income tax purposes; however, bond premium on such Series 2002-1 Bonds is treated as an offset to qualified stated interest received on such Series 2002-1 Bonds. Owners of such Bonds should consult their tax advisors with respect to the determination for Federal income tax purposes of the treatment of bond premium upon sale or other disposition of such Bonds and with respect to the state and local tax consequences of owning and disposing of such Bonds.

Legislation affecting municipal securities is constantly being considered by the United States Congress. There can be no assurance that legislation enacted after the date of issuance of the Series 2002-1 Bonds will not have an adverse effect on the tax-exempt status of the Series 2002-1 Bonds. Legislative or regulatory actions and proposals may also affect the economic value of the tax exemption or the market price of the Series 2002-1 Bonds.

LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2002-1 Bonds or questioning the creation, organization or existence of TSASC, the validity or enforceability of the Indenture, the sale of the TSRs by the City to TSASC, the proceedings for the authorization, execution, authentication and delivery of the Series 2002-1 Bonds or the validity of the Series 2002-1 Bonds.

RATINGS

It is expected that the Series 2002-1 Bonds will be assigned ratings by each of Moody's Investors Service, Inc. ("**Moody's**"), Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("**S&P**") and Fitch Ratings ("**Fitch**") (collectively, the "**Rating Agencies**") as set forth in the table below.

The ratings address each Rating Agency's assessment of the ability of TSASC to pay interest and Principal Installments when due on the Series 2002-1 Bonds and the other Senior Bonds outstanding as of the date of issuance of the Series 2002-1 Bonds. The ratings do not address TSASC's ability to make Super Sinker Redemptions or to make Extraordinary Prepayments, if any, nor do they address the effects of the issuance of future Program Bonds.

The respective ratings by Moody's, S&P and Fitch of the Series 2002-1 Bonds reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agencies with respect thereto should be obtained from the Rating Agency furnishing the same, at the following addresses: Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007; Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041; and Fitch Ratings, One State Street Plaza, New York, New York 10004.

There is no assurance that the initial ratings assigned to the Series 2002-1 Bonds will continue for any given period of time or that any of such ratings will not be revised downward or withdrawn entirely by any of the Rating Agencies. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2002-1 Bonds.

Bonds	Expected Ratings Moody's	S&P	Fitch
Serial Maturities (2006-2007)	Aa1	AA–	A+
Serial Maturities (2008-2012)	Aa1	A+	A+
Serial Maturities (2013-2014)	Aa1	A	A+
Super Sinker Term Bonds Maturing July 15, 2024	Aa1	A	A+
Super Sinker Term Bonds Maturing July 15, 2032	Aa2	A	A+

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 2002-1 Bonds from TSASC at an underwriters' discount of $3,689,785.57. The Underwriters will be obligated to purchase all of the Series 2002-1 Bonds if any are purchased. The initial public offering prices of the Series 2002-1 Bonds may be changed from time to time by the Underwriters.

The Series 2002-1 Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2002-1 Bonds into investment trusts) at prices lower than such public offering prices.

LEGAL MATTERS

Sidley Austin Brown & Wood LLP, New York, New York, Transaction Counsel, will render opinions with respect to the validity of the Series 2002-1 Bonds in substantially the form set forth in Appendix E hereto. Such firm currently acts as counsel for and against the City in certain other unrelated matters.

Certain legal matters with respect to the City will be passed upon by its Corporation Counsel and Sidley Austin Brown & Wood LLP, New York, New York, as Transaction Counsel.

Certain legal matters will be passed upon for the Underwriters by Orrick, Herrington & Sutcliffe LLP, New York, New York, as Underwriters' Counsel.

FINANCIAL STATEMENTS

The TSASC financial statements for Fiscal Years ended June 30, 2001 and 2000 included in Appendix D to this Offering Circular have been audited by Grant Thornton LLP, independent certified public accountants, to the extent indicated in their report thereon which appears in Appendix D hereto. Such financial statements have been included in reliance upon the report of Grant Thornton LLP.

RELATIONSHIPS AMONG THE PARTIES

Citibank, N.A., the MSA Escrow Agent, is a wholly-owned subsidiary of Citigroup, Inc. Salomon Smith Barney Inc., one of the senior managing Underwriters, is also a wholly-owned subsidiary of Citigroup, Inc. Salomon Smith Barney Inc. is also the investment advisor to the MSA Escrow Agent.

OTHER PARTIES

Financial Advisor

Arimax Financial Advisors Inc., New York, New York ("**Arimax**") has been retained to act as financial advisor for TSASC in connection with the issuance of the Series 2002-1 Bonds.

Although Arimax has assisted in the preparation of this Offering Circular, Arimax is not obligated to undertake, and has not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in this Offering Circular.

DRI•WEFA

DRI•WEFA has been retained by TSASC as an independent econometric consultant. The DRI•WEFA Report attached as Appendix A hereto is included herein in reliance on DRI•WEFA as experts in such matters. DRI•WEFA's fees for acting as TSASC's independent economic consultant are not contingent upon the issuance of the Series 2002-1 Bonds. The DRI•WEFA Report should be read in its entirety.

INDEX OF DEFINED TERMS

APPENDIX A

A Forecast of U.S. Cigarette Consumption (2001-2042) for TSASC, Inc.

Submitted to:

TSASC, Inc.

Prepared by:

DRI•WEFA, Inc.

August 1, 2002

DRI•WEFA
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Jim Diffley
Group Managing Director

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Executive Summary

DRI•WEFA has developed a cigarette consumption model based on historical U.S. data between 1965 and 2000. 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 2001 through 2042. Our Base Case Forecast indicates that total consumption in 2042 will be 210 billion cigarettes (approximately 10.5 billion packs), a 51% decline from the 2000 level. We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2042 US cigarette consumption could be as low as 192 billion and as high as 225 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 DRI•WEFA'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.

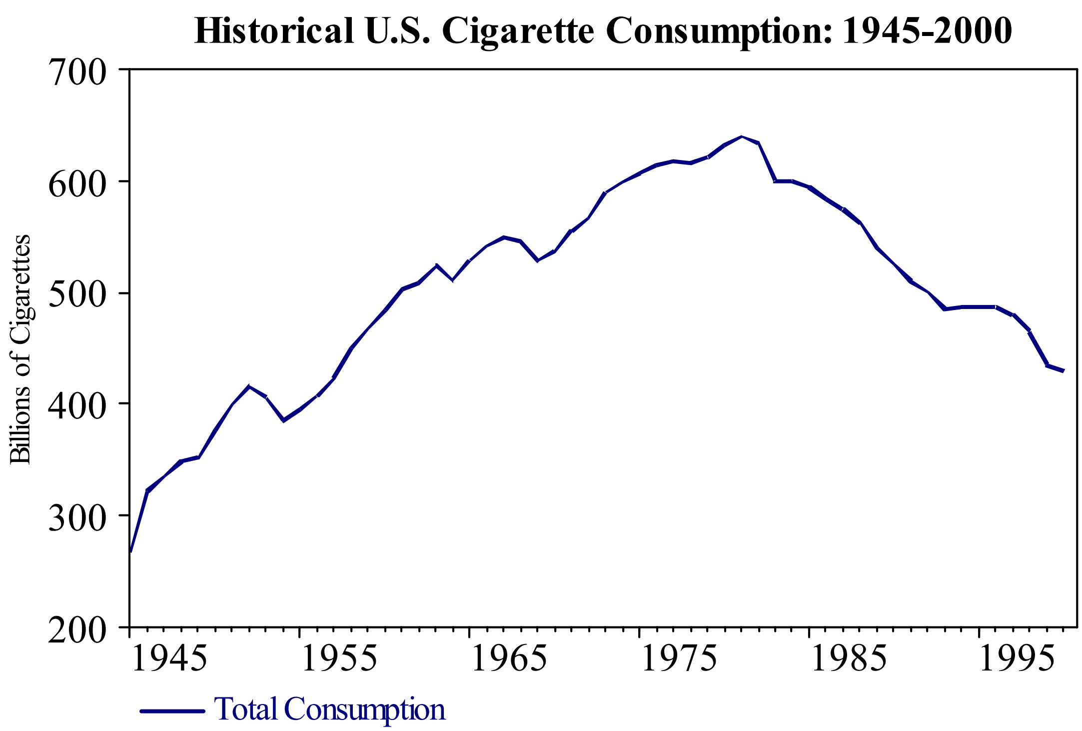
This forecast differs slightly from the one presented by DRI•WEFA in 2001 ("DRI•WEFA's 2001 Forecast"). In the year 2000, lower than expected prices, resulted in higher than expected consumption. The United States Department of Agriculture ("USDA"**),** now estimates a consumption level for year 2000 of 430 billion, 7 billion more than DRI•WEFA's forecast in 2001. DRI•WEFA has also revised its year 2001 consumption estimate upwards, to 419 billion from 408 billion. This forecast also differs somewhat from one presented to other issuers earlier in 2002. While that forecast had anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the previous forecast, and to 392 billion in 2003, 5.6 billion fewer than the previous forecast.

Disclaimer

The projections and forecasts regarding future cigarette consumption included in this 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. 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, 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[1]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol Tobacco and Firearms. The United States Department of Agriculture ("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[3]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998 and 430 billion cigarettes in 2000[4].



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

[1] *Source*: "Tobacco Timeline," Gene Borio (1998).
[2] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.
[3] *Source*: "Tobacco Situation and Outlook", U.S. Department of Agriculture-Economic Research Service, September 1999 (USDA-ERS).
[4] *Source*: USDA-ERS, September 2001.

and 1932. Notwithstanding this steep decline, consumption rapidly increased after 1932, exceeding previous levels by 1934. Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.20% 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 then the decline for 1999 accelerated to 6.45%. These sharp recent declines are correlated with large price increases in 1998 and 1999.

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 recent declines are correlated with large price increases in 1998 and 1999. All percentages are based upon compound annual growth rates.

The following table sets forth United States domestic cigarette consumption for the six years ended December 31, 2000[5]. 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 Master Settlement Agreement dated November 23, 1998 (MSA) 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
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13
1997	480	-1.44
1996	487	0.00
1995	487	0.21

[5] *Source*: USDA-ERS.

The US Cigarette Industry

The cigarette market is an oligopoly in which, according to reports of the manufacturers, the four leading manufacturers accounted for almost 94% of the market in 2001. These top four companies in shipments were Philip Morris, RJ Reynolds, Brown & Williamson, and Lorillard, who occupied 50.9 percent, 22.3 percent, 10.9 percent, and 9.5 percent of the market respectively, as reported by each individual manufacturer.

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 percent in 1950 to approximately 0.5 percent today. In 2000, the federal government received $7.5 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $8.7 billion in 2000, from excise and sales taxes. Cigarettes constitute the majority of these sales, which include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

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

Incidence of Smoking

Approximately 46.5 million American adults were current smokers in 2000, representing approximately 23.3% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[6] released in July 2002. 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,[7] the incidence rate declined relatively slowly through the next decade.

[6] *Source*: CDC. Morbidity and Mortality Weekly Report, "Cigarette Smoking Among Adults – United States, 2000," July 26, 2002.
[7] *Source*: CDC, Office on Smoking and Health.

The National Center for Health Statistics also presents a preliminary estimate of adult incidence for 2000 of 23.3%.[8]

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 2001, however, the incidence had fallen to 28.5%, just 3.6% above the 1991 level.[9]

The Youth Tobacco Surveillance (YTS) report, issued in November 2001 by the CDC, is a supplement to the Youth Risk Behavior Survey.[10] The YTS covers calendar year 2000 and provides more comprehensive data on tobacco use among both middle and high school students as well as data on secondhand smoke exposure, ability to obtain tobacco products, and knowledge of, and attitudes about, tobacco and tobacco advertising (both pro- and anti-tobacco). Some of the results pertaining to cigarette use can be found in the table below.

Youth Risk Behavior Survey

	Middle School Students Grades 6-8	High School Students Grades 9 -12
Ever Used Tobacco	36.3%	64.0%
Current Cigarette Users	11.0%	28.0%
Ever Smoked Cigarettes Daily	5.5%	20.6%
First Smoked Before Age 11	8.4%	6.7%

8 *Source*: National Center for Health Statistics, National Health Interview Survey. September 20, 2001

9 *Source*: CDC, Morbidity and Mortality Weekly Report, "Trends in Cigarette Smoking Among High School Students ---United States, 1991-2001," May 17, 2002.

10 CDC, CDC Surveillance Summaries, November 2, 2001, MMWR 2001:50(No.SS-4).

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 among eighth, tenth and twelfth graders was lower in June 2001 than in June 2000, the fourth consecutive annual decline. However, incidence levels for 10th and 12th graders continue to remain higher than in June 1991.[11] Smoking incidence for 8th graders has fallen below its level in 1991.

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

Grade	June 1991	June 2000	June 2001	'00-'01 Change (%)	'91-'01 Change (%)
8th	14.3	14.6	12.2	-16.4	-14.7
10th	20.8	23.9	21.3	-10.9	2.40
12th	28.3	31.4	29.5	-6.1	4.24

The 2000 Household Survey on Drug Abuse conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services estimated that approximately 55.7 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 25.8% in 1999. The same survey found that an estimated 13.4% of youths age 12 to 17 were current cigarette smokers in 2000, a decrease from 14.9% in 1999.

Price Elasticity of Cigarette Demand

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

Two studies recently 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

[11] *Source*: University of Michigan , Monitoring the Future Study, December 2001.
[12] Chalpouka FJ,Warner KE:P.5.

smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[13] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[14] The price elasticity of cessation for males averaged 1.12 and for females averaged 1.19 in this study. These estimates imply that a 1% increase in the real price of cigarettes will result in an increase in the probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively.

In another study, Czart et al.(2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 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%."[15]

Tauras et al. 2001) conducted a study that looked at the effects of price on teenage smoking initiation.[16] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least 1-5 cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticites of initiation are –0.27 for any smoking, -0.81 for smoking at least 1-5 cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined.

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[13] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780, National Bureau of Economic Research, 2000.
[14] Source: Tauras, John A. and Chaloupka, Frank, J.. "Determinants of Smoking Cessation: An Analysis of Young Adult Men and Women." Working Paper No. W7262, National Bureau of Economic Research, 1999.
[15] 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.
[16] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press, Copyright 2001.

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.[17] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992."

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.[18] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10 percent. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day that a smoker spends working in an environment where there are smoking restrictions, the greater is the decline in the quantity of cigarettes consumed by that smoker.

Factors Affecting Cigarette Consumption

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

General Population Growth. DRI•WEFA forecasts that the United States population will increase from approximately 272 million in 1999 to approximately 385 million in 2043. This forecast is consistent with the Bureau of the Census forecast based on the 1990

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

[18] *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.

Census. On December 28, 2000 the Bureau reported results from the 2000 Census that estimate the US population on April 1, 2000 to be 281 million. We have not yet incorporated this data into our analysis because it has yet to be reconciled, by the Bureau, to its 1990 estimate. That 1990 Census estimate likely suffered from a significant undercount of population. As the USDA, in its estimate of per capita consumption, also uses the estimates based on the 1990 Census, our forecast is consistent with its history. When the correct population data from 1990 to 2000 is released, it is expected to show that per capita consumption of cigarettes was slightly lower than originally thought, but that its growth trend is the same. We do not expect the revised population and per capita consumption levels to affect our forecast of total cigarette consumption.

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 DRI•WEFA's multivariate regression analysis using data from 1965 to 1999, the long run price elasticity of consumption for the entire population is -0.31; a 1.0% increase in the price of cigarettes decreases consumption by 0.31%.

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 intended to offset the costs of the MSA and agreements with previously settled states. The cigarette manufacturers have since increased wholesale prices on seven occasions: in August 1999 by $0.18 per pack, in January 2000 by $0.13 per pack, in July 2000 by $0.06 per pack, in December 2000 by $0.14 per pack, on April 25, 2001 by $0.14 per pack, on October 29, 2001 by $0.05 per pack, and most recently on April 1, 2002 by $0.12 per pack. For the year 2000, we estimate that the average price per pack was $3.20, representing a nominal growth in the price of cigarettes of 11.0% from 1999. For 2001, we estimate that the average price was $3.45.

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, Maine, Rhode Island, Washington, West Virginia, and Wisconsin all increased their tax on cigarettes. They were followed, in January 2002, by a scheduled increase in the federal excise tax of $0.05 per pack, and in April 2002, by excise tax increases in New York and Connecticut. As a result of these increases, we estimate that average retail prices across the U.S. had risen, in May 2002, to $3.64 per pack.

On July 1, 2002 excise tax increases went into effect in Illinois, Indiana, Kansas, Louisiana, Maryland, New Jersey, New York City, Ohio, Pennsylvania, Rhode Island, Utah, and Vermont. Also, Hawaii, Massachusetts, Michigan, Tennessee, and Nebraska will increase taxes later in 2002. These increases range from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They average $0.45 per pack, and will boost the nationwide average retail price by $0.18. The average state excise tax is now over $0.60 per pack. These states are among at least thirty states which have considered increases in excise taxes as a response to budget shortfalls following the 2001 recession. Our base case forecast assumes that California and another smaller state will also enact tax increases in the second half of 2002. This will result in an average price per pack that increases from $3.50 at the start of 2002 to $3.80 in July, and to over $4.00 in 2003. Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to costs related to the MSA and further increases in excise taxes, among other reasons.

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. Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped.

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.[19] However, a few studies found cigarette consumption decreases as disposable income increases.[20] Based on our multivariate regression analysis using data from 1965 to 1999, 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,[21] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[22] One study examines the effects of youth smoking on future adult smoking.[23] 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

[19] Ippolito, et al.; Fuji.
[20] Wasserman, et al.; Townsend et al.
[21] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[22] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[23] *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.

subsequent health warnings, together with the increased health awareness of the population over the past thirty years, may have contributed to decreases in cigarette consumption levels. If, as we assume, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Our analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify.

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

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. As of 1999, 48 states and the District of Columbia required smoke-free indoor air to some degree or in some public places.[24] Based on the regression analysis using data from 1965 to 1999, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restriction instituted beginning in the late 1970's has reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. 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.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[25] and the American Medical Association[26] (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.

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[24] *Source*: American Lung Association, "State Legislated Actions on Tobacco Issues", 1999.
[25] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".
[26] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes, "Report to the AMA House of Delegates, June 1998.

Other Considerations

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

The Surgeon General's Report documents evidence of the effectiveness of five major modalities for reducing tobacco use. Educational strategies are shown to be effective in postponing or preventing adolescent smoking. Pharmacologic treatment of nicotine addiction, combined with behavioral support, can enhance abstinence efforts. Regulation of advertising and promotional activities of manufacturers can reduce smoking, particularly among youth. Clean air regulations and restricted minor's access contribute to lessening smoking prevalence. And excise tax increases will reduce cigarette consumption. Further support for the efficacy of such programs is provided in an analysis by Farrelly, Pechacek, and Chaloupka.[27] They estimate that tobacco control program expenditures between 1988 and 1998 resulted in a decline in cigarette sales of 3%.

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.[28] 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 growers 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 calls for a 17-cent increase in the excise tax on all packs of cigarettes sold in

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

[28] "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.

the United States. The increased revenues would then be deposited into a fund and earmarked for the recommended programs.

Our research has indicated, and our model incorporates, a negative impact on cigarette consumption of 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. Similarly, the Justice Department has indicated that, as part of a lawsuit against the tobacco companies, it may seek to require graphic health warnings covering 50 percent of cigarette packs. In addition, it would prohibit in-store promotions and require that all advertising and packaging be black-and-white. 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, by 2003, only cigarettes that self-extinguish. We expect that an agreement will be reached by then on a nationwide standard. We do not believe that either the New York statute or a nationwide agreement 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.

Similarly, on January 16, 2001, Vector Group Ltd. announced plans to introduce a virtually nicotine-free cigarette. This non-addictive product might be used as a tool to quit or reduce smoking. We view this as a continuation of efforts to provide products, such as the nicotine patch, that are supposed to reduce smoking addiction. These products have likely contributed to the trend decline in consumption incorporated into our model. In our forecast, we expect such efforts to continue to reduce per capita cigarette consumption.

An Empirical Model of Cigarette Consumption

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

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

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

Using U.S. data from 1965 through 1999 on the variables described above, we developed the following regression equation. All of the data sources are detailed in Appendix 1 of this Report.

$$
\begin{aligned}
\log(cpc) = {} & 53.3410 - 0.02316 * trend \\
& - 0.21193 * \log(cigprice) - 0.09367 * \log(cigprice)(-1) \\
& + 0.26979 * \log(ydp96pc) - 0.01901 * smokeban
\end{aligned}
$$

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

This model has an R-square in excess of 0.99, meaning that it explains more than 99 per cent of the variation in US adult per capita cigarette consumption over the 1965 to 1999 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. We estimate youth consumption in 1999 at 5.92 billion cigarettes. Youth incidence is expected to gradually decline, and our estimated consumption levels will fall to 2.37 billion in 2042.

Dependent Variable

Adult Per Capita Cigarette Consumption (CPC)

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

Explanatory Variables

The Real Price of Cigarettes (CIGPRICE)

Reliable data on retail cigarette prices from the consumer price index (CPI) are only available since 1997, an inadequate time frame to build our model. However, tobacco CPI, which is available for the entire period of analysis, closely follows cigarette prices, since cigarettes constitute over 95 per cent 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 –0.21 measures the short-run elasticity of cigarette demand. That is, a 1% increase in price reduces consumption by 0.21% in the current year. The second coefficient, -0.09 relates to prices in the previous year. It indicates that, following a 1% increase, an additional decrease in cigarette consumption of 0.09% will occur. Thus, according to the data, a one per cent increase in price decreases cigarette consumption by 0.31 (.3055) 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 -0.24 and -0.38. 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 percent. 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 2.32 per cent 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 (53.34) 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 DRI•WEFA 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 brought prices to an average of $2.88 per pack in 1999 and $3.20 in 2000. The most recent increase of $0.12 on April 1, 2002, coupled with excise tax increases, brings the current retail price to approximately $3.65. Our consumption model anticipates that for the year 2002 the average price per pack will be $3.73, and that this will increase further to $4.05 in 2003. Much of this increase will be due to state excise tax increases. These increases will result in retail price growth in excess of 8% per year in 2002 and 2003. Price increases will then moderate for a few years as state tax increases that would have been expected over the 2004 to 2006 period were accelerated into 2002. The cigarette manufacturers will be less aggressive in raising prices in the short term as well, in order to compensate for the state actions which reduce cigarette demand. At the same time, coincidentally, payments due under the MSA will fall after the last initial payment in January 2003.

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 manufacture is dominated by a few firms, price changes will typically be discrete events, with jumps such as occurred on August 31, 1999 and December 18, 2000, 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 over $23 by 2042, which is $7.80 in 2000 dollars. Relative to other goods, cigarette prices will rise by an average of 2.3% 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 not taper off until 2003, despite recent administrative initiatives to curb underage smoking. This is due to the momentum provided by current youth smokers. We then assume that youth smoking declines following the longer term trend of the 1970's and 1980's. By 2042 we assume that youth smoking will have declined at an average annual rate of 2.1% since 1999, or by 60% overall.

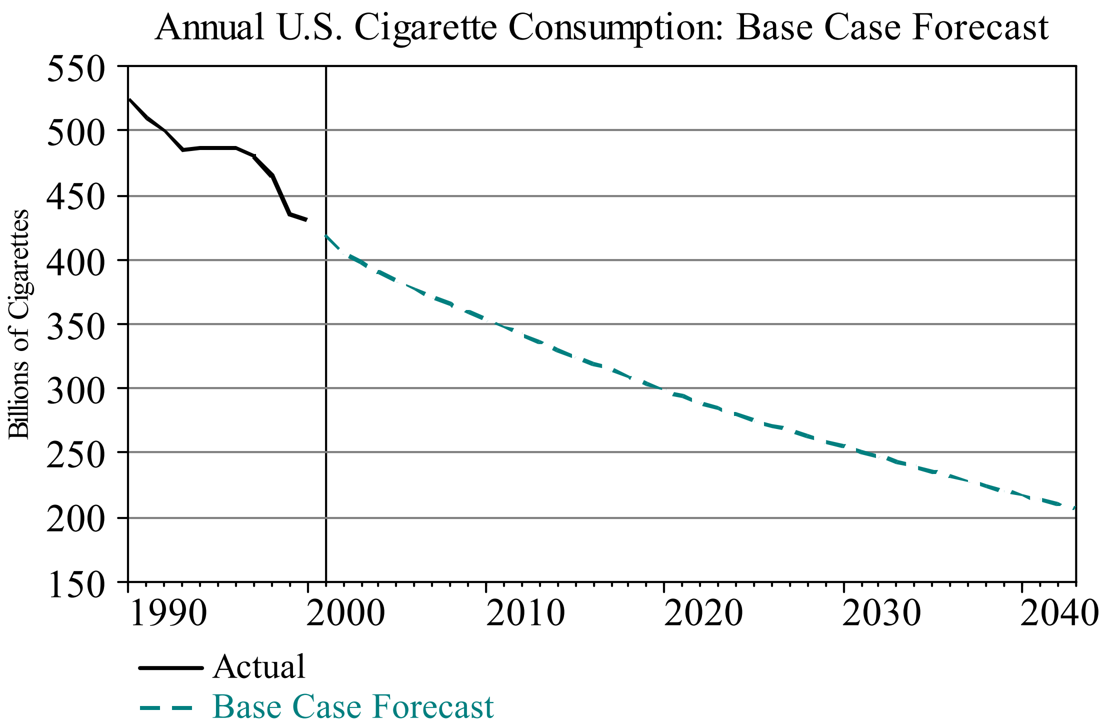
We believe the assumptions on which the Base Case Forecast are based to be reasonable.

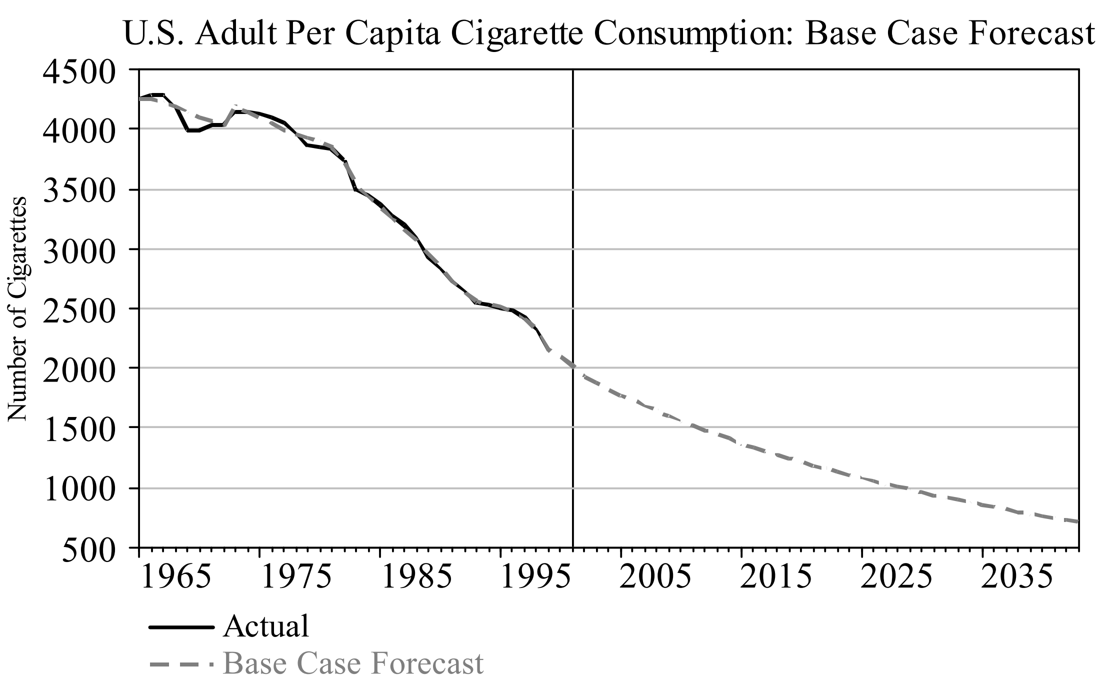
Forecast of Cigarette Consumption

After developing the regression equation specified above, we used it to project CPC for the period 2001 through 2042. Then using the standard adult population projections of DRI•WEFA'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 1999 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.

While consumption declined by an estimated 6.45% in 1999, industry shipments declined by almost 9%. The relative performance of shipments was expected to be better in 2000. Considerable inventory building occurred in late 1998 as wholesalers ordered ahead of the November 1998 price increase. This increase in inventories was followed by a fall in shipments in early 1999 as the stockpiled cigarettes were distributed to retail outlets. Thus total 1999 shipments showed a particularly sharp fall from 1998 levels. Also the shipments of the four "Original Participating Manufacturers" declined relative to the overall market as their market share declined. On January 25, 2001, RJ Reynolds reported that domestic industry shipments in 2000 increased by 0.1% over 1999. For the reasons given above, shipment volumes in the first half of the year exceeded the depressed 1999 levels, while volume decreased in the second half by 2.58% from the second half of 1999. Industry shipments for 2001 were, at 406.3 billion, 3.2% below 2000.

Cigarette consumption is projected to decline by 3.8% in 2002, and 2.8% in 2003. After 2003, the rate of decline is projected to moderate and average less than 2% per year. From 2000 through 2042 the average annual rate of decline is projected to be 1.69%. On a per capita basis consumption is projected to fall at an average rate of 2.48% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 430 billion in 2000 to under 400 billion by 2003, under 300 billion by 2020, and to reach 210 billion in 2042.

Statistical Confidence and Forecast Error

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

Comparison With Prior Forecasts

On October 25, 1999 DRI•WEFA presented a similar study, "A Forecast of US Cigarette Consumption (1999-2042)". Its long run conclusions were quite similar to this study. By 2042, the current forecast is 7% greater than the 1999 forecast, 210 billion vs. 196 billion. In the 1999 study our projected level of 1999 consumption was 432 billion; the estimated number from the USDA was slightly higher, 435 billion.

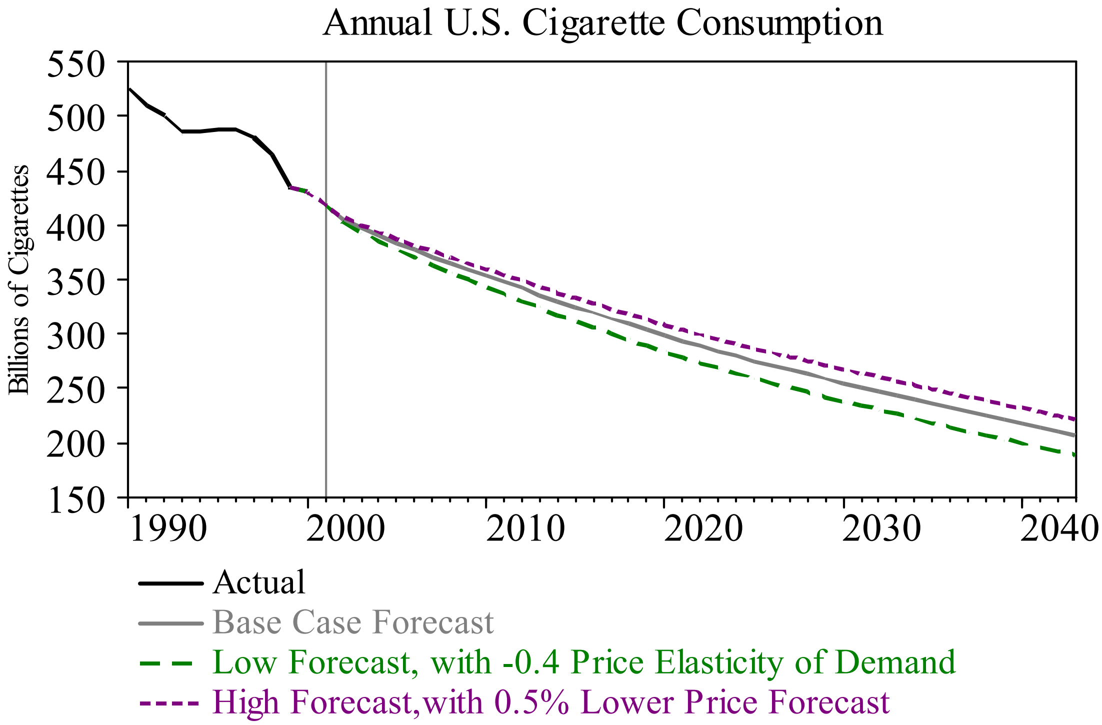
We incorporated this and other new data in 2000. At that time we realized that price increases had been greater than anticipated in our 1999 study. We increased our retail price assumption for 2000 from \$3.03 to \$3.39, and correspondingly decreased our consumption forecast for the year to 411 billion. However, aggressive discounting at the retail level resulted in a lower average price for the year, \$3.20 per pack. Similarly, in 2001 retail prices averaged \$3.44 per pack, 4.4% lower than the \$3.60 our forecast had assumed. Increased consumption due to lower than anticipated prices explains most of the revision to our 2000 and 2001 consumption forecasts. We now estimate a consumption level of 419 billion for 2001, 11 billion more than we projected in our 2001 forecast. This forecast also differs somewhat from one presented to other issuers earlier in 2002. While that forecast had anticipated some state excise tax increases in response to state budget difficulties, a slightly greater number of states than expected have raised taxes on cigarette purchases, and as a result, consumption is projected to be lower in the near term. Cigarette consumption is now expected to fall to 403 billion in 2002, 2 billion fewer than the previous forecast, and to 392 billion in 2003, 5.6 billion fewer than the previous forecast.

Alternative Forecasts

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

The high and low alternative forecasts are derived as follows. For the high scenario, we use a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than our current base case forecast. Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.69 to 1.53%, resulting in consumption of 225 billion in 2042.

In the low forecast, Low Case 1, we posit a sharper price elasticity of demand. Our estimate of the price elasticity, -0.31, 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 1.90% and results in cigarette consumption of 192 billion in 2042.



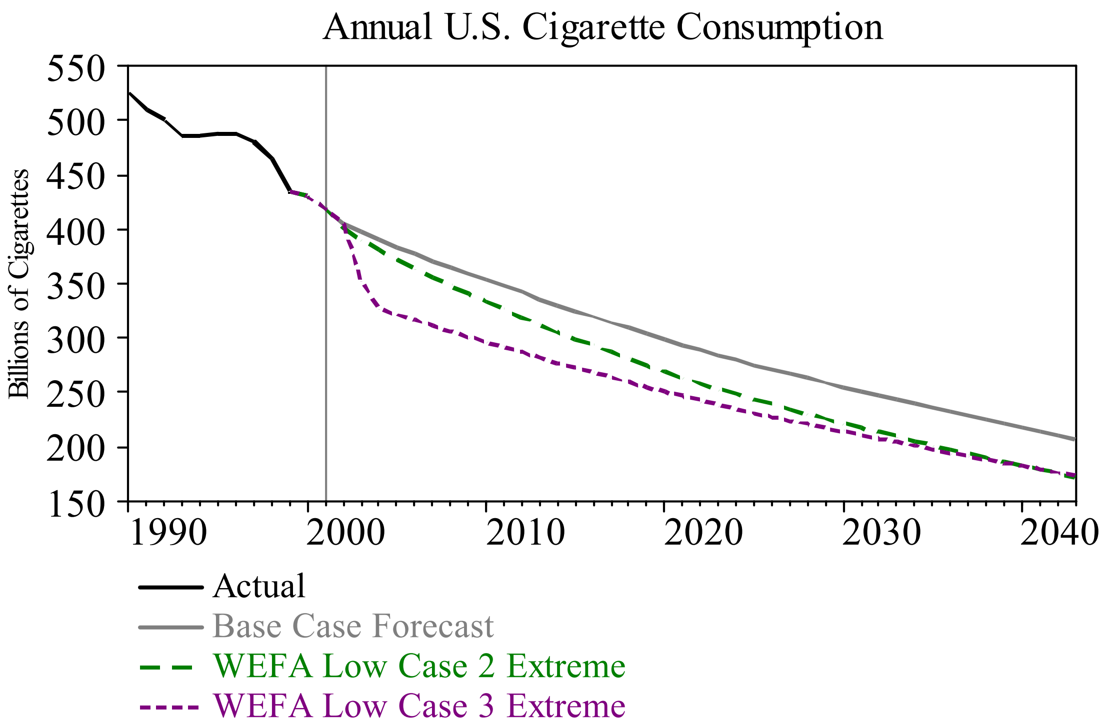
Hypothetical Stress Scenarios

The model was also tested under more extreme, and concurrently, less likely conditions. These exercises do not represent informed anticipation of possible future conditions. Rather, they are meant only to test the model under extreme conditions. First, we increased the negative response of consumer demand to recent price increases by assuming a much larger, -0.5, elasticity. This sharpens the fall in total consumption to an average annual rate of 2.12%, and results in demand of 175 billion cigarettes in 2042 (DRI•WEFA Low Case 2). This scenario would also be the result if, instead of a greater price sensitivity of smokers, we postulated an increased rate of cigarette price increase. Indeed, if cigarette prices, instead of averaging increases in real terms of 2.30% per year, accelerated to a pace of 3.97% annually, demand would also fall to 175 billion in 2043.

A second large negative stress is placed by postulating, in 2003, 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, -17.7% over two years, in consumption. By 2042, consumption will have fallen to 176 billion cigarettes, an average annual rate of decline of 2.10% (DRI•WEFA Low Case 3). The estimated price elasticity of –0.31 is used in this case. This results in slightly higher consumption by 2042 than in DRI•WEFA Low Case 2, despite the higher prices.

Alternative Forecasts

	2042 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	210	1.69
Low Case 1	192	1.90
High Alternative	225	1.53
Low Case 2	175	2.12
Low Case 3	176	2.10



Finally, for comparative purposes we have calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4%. At 3.5% per year consumption falls to 96 billion by 2042 and at 4% it falls to 77 billion.

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	4.11	0.92	1.28	0.04		
1967	3.13	0.72	1.39	0.05		
1968	3.55	1.89	1.56	0.05		
1969	2.21	0.00	1.69	0.06		
1970	2.97	2.24	2.00	0.05		
1971	2.81	0.12	2.27	0.06		
1972	3.43	2.08	2.85	0.06		
1973	5.76	-3.29	2.03	0.07		
1974	-1.19	-5.49	2.05	0.07		
1975	0.97	-1.87	2.12	0.05		
1976	2.93	-1.40	2.07	0.05		
1977	2.44	-1.60	1.91	0.07		
1978	4.10	-2.05	1.91	0.06		
1979	2.02	-4.73	2.00	0.05		
1980	0.01	-5.03	1.96	0.05		
1981	1.56	-2.11	1.73	0.06		
1982	0.59	4.80	1.64	0.05		
1983	1.93	15.84	1.46	0.04		
1984	6.79	2.10	1.48	0.05		
1985	2.45	2.31	1.16	0.05		
1986	2.28	4.84	1.38	0.06		
1987	1.37	3.36	1.23	0.05		
1988	3.50	4.83	1.26	0.05		
1989	1.53	7.64	1.35	0.05		
1990	1.10	4.71	0.89	0.06	7.96	
1991	-0.38	7.16	0.96	0.06	7.72	
1992	2.29	5.24	0.99	0.06	7.62	
1993	-0.04	0.91	1.02	0.06	7.12	
1994	1.56	-6.11	0.95	0.07	7.21	
1995	1.72	-0.21	0.85	0.07	7.76	
1996	1.57	0.18	0.89	0.08	7.54	
1997	2.20	2.31	1.27	0.08	6.58	
1998	4.45	11.03	1.15	0.08	6.30	2.20
1999	1.58	26.72	1.13	0.08	5.92	2.88
2000	2.61	7.47	1.14	0.08	5.92	3.20
2001	2.60	4.36	1.10	0.08	5.92	3.45
2002	0.63	6.26	1.02	0.08	5.91	3.73
2003	2.26	5.53	0.96	0.08	5.87	4.05
2004	2.14	1.11	0.87	0.08	5.84	4.21
2005	2.23	1.35	0.98	0.08	5.82	4.39
2006	2.66	2.11	0.89	0.08	5.80	4.59
2007	2.56	2.41	1.00	0.08	5.78	4.82
2008	2.15	2.71	1.00	0.08	5.77	5.08
2009	2.00	3.10	1.02	0.07	5.77	5.37

Year	Real Per Capita Personal Income	Real Price of Cigarettes	U.S. Adult Population	Incidence of Smoking in 12-17 Age Group	Youth Consumption	Average Price Per Pack of Cigarettes
	Growth Rate (%)	*Growth Rate (%)*	*Growth Rate (%)*	*%*	*Billions*	*$ (Current)*
2010	2.21	2.61	1.00	0.07	5.62	5.65
2011	2.23	2.57	0.93	0.07	5.47	5.94
2012	2.02	2.52	0.88	0.07	5.32	6.24
2013	2.02	2.48	0.81	0.07	5.18	6.55
2014	2.02	2.84	0.80	0.07	5.18	6.90
2015	2.04	2.02	0.84	0.07	5.18	7.22
2016	2.04	2.37	0.82	0.07	5.18	7.58
2017	2.05	2.34	0.77	0.07	5.18	7.94
2018	2.05	2.31	0.76	0.07	5.18	8.33
2019	2.06	2.27	0.74	0.06	5.03	8.73
2020	2.08	1.89	0.76	0.06	4.88	9.12
2021	2.09	2.22	0.77	0.06	4.73	9.55
2022	2.10	1.85	0.77	0.06	4.59	9.97
2023	2.11	2.17	0.78	0.06	4.44	10.45
2024	2.11	1.81	0.78	0.06	4.44	10.90
2025	2.11	1.79	0.79	0.05	4.29	11.38
2026	2.11	1.78	0.79	0.05	4.14	11.86
2027	2.11	1.76	0.79	0.05	3.99	12.37
2028	2.11	1.75	0.80	0.05	3.85	12.91
2029	2.11	1.73	0.80	0.05	3.70	13.46
2030	2.11	2.02	0.80	0.05	3.70	14.07
2031	2.11	1.70	0.79	0.04	3.55	14.67
2032	2.11	1.68	0.77	0.04	3.40	15.29
2033	2.11	1.67	0.76	0.04	3.25	15.94
2034	2.11	1.66	0.75	0.04	3.11	16.60
2035	2.11	2.50	0.74	0.04	2.96	17.45
2036	2.11	1.62	0.72	0.04	2.96	18.17
2037	2.11	1.89	0.71	0.04	2.96	18.97
2038	2.11	1.59	0.70	0.04	2.96	19.76
2039	2.11	1.85	0.69	0.03	2.81	20.63
2040	2.11	1.57	0.68	0.03	2.66	21.47
2041	2.11	1.56	0.67	0.03	2.51	22.35
2042	2.11	1.81	0.66	0.03	2.37	23.32

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

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2326	-4.00	465.00	23.25	-3.13
1999	2136	-8.17	435.00	21.75	-6.45
2000	2092	-2.06	430.00	21.50	-1.15
FORECAST					
2001	2017	-3.59	419.00	20.95	-2.56
2002	1920	-4.82	402.96	20.15	-3.83
2003	1849	-3.70	391.85	19.59	-2.76
2004	1801	-2.57	385.27	19.26	-1.68

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
2005	1763	-2.14	380.68	19.03	-1.19
2006	1725	-2.16	375.67	18.78	-1.32
2007	1684	-2.35	370.50	18.53	-1.38
2008	1642	-2.49	365.00	18.25	-1.48
2009	1598	-2.65	358.90	17.95	-1.67
2010	1558	-2.54	353.27	17.66	-1.57
2011	1519	-2.48	347.65	17.38	-1.59
2012	1481	-2.52	341.81	17.09	-1.68
2013	1444	-2.51	335.90	16.79	-1.73
2014	1406	-2.58	329.95	16.50	-1.77
2015	1372	-2.44	324.71	16.24	-1.59
2016	1339	-2.44	319.48	15.97	-1.61
2017	1306	-2.46	314.11	15.71	-1.68
2018	1274	-2.45	308.83	15.44	-1.68
2019	1243	-2.44	303.49	15.17	-1.73
2020	1213	-2.36	298.55	14.93	-1.63
2021	1184	-2.39	293.59	14.68	-1.66
2022	1157	-2.34	288.83	14.44	-1.62
2023	1129	-2.37	284.10	14.20	-1.64
2024	1103	-2.32	279.72	13.99	-1.54
2025	1078	-2.29	275.39	13.77	-1.55
2026	1053	-2.28	271.14	13.56	-1.54
2027	1029	-2.28	267.00	13.35	-1.53
2028	1006	-2.27	262.94	13.15	-1.52
2029	983	-2.27	258.94	12.95	-1.52
2030	960	-2.33	255.01	12.75	-1.52
2031	938	-2.29	251.03	12.55	-1.56
2032	917	-2.26	247.16	12.36	-1.54
2033	896	-2.25	243.36	12.17	-1.54
2034	876	-2.25	239.56	11.98	-1.56
2035	855	-2.42	235.39	11.77	-1.74
2036	835	-2.32	231.65	11.58	-1.59
2037	816	-2.29	227.99	11.40	-1.58
2038	797	-2.26	224.45	11.22	-1.55
2039	779	-2.28	220.75	11.04	-1.65
2040	762	-2.25	217.15	10.86	-1.63
2041	745	-2.22	213.66	10.68	-1.61
2042	728	-2.27	210.09	10.50	-1.67

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

Year	**Base Case Forecast**			**Low Case 1: -0.4 Price Elasticity of Demand**			**High Forecast: Lower Price Assumption**		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
1999	435.00	21.75	-6.45	435.00	21.75	-6.45	435.00	21.75	-6.45
2000	430.00	21.50	-1.15	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	419.00	20.95	-2.56	419.00	20.95	-2.56	419.00	21.50	-1.15
2002	402.96	20.15	-3.83	399.56	19.98	-4.64	404.76	20.24	-3.40
2003	391.85	19.59	-2.76	386.01	19.30	-3.39	394.29	19.71	-2.59
2004	385.27	19.26	-1.68	379.20	18.96	-1.77	388.28	19.41	-1.52
2005	380.68	19.03	-1.19	374.22	18.71	-1.31	384.31	19.22	-1.02
2006	375.67	18.78	-1.32	368.64	18.43	-1.49	379.89	18.99	-1.15
2007	370.50	18.53	-1.38	362.73	18.14	-1.61	375.26	18.76	-1.22
2008	365.00	18.25	-1.48	356.29	17.81	-1.77	370.11	18.51	-1.37
2009	358.90	17.95	-1.67	349.35	17.47	-1.95	364.48	18.22	-1.52
2010	353.27	17.66	-1.57	343.02	17.15	-1.81	359.31	17.97	-1.42
2011	347.65	17.38	-1.59	336.78	16.84	-1.82	354.17	17.71	-1.43
2012	341.81	17.09	-1.68	330.35	16.52	-1.91	348.75	17.44	-1.53
2013	335.90	16.79	-1.73	323.87	16.19	-1.96	343.24	17.16	-1.58
2014	329.95	16.50	-1.77	317.33	15.87	-2.02	337.71	16.89	-1.61
2015	324.71	16.24	-1.59	311.71	15.59	-1.77	332.85	16.64	-1.44
2016	319.48	15.97	-1.61	306.04	15.30	-1.82	327.99	16.40	-1.46
2017	314.11	15.71	-1.68	300.26	15.01	-1.89	323.00	16.15	-1.52
2018	308.83	15.44	-1.68	294.61	14.73	-1.88	318.09	15.90	-1.52
2019	303.49	15.17	-1.73	288.90	14.44	-1.94	313.07	15.65	-1.58
2020	298.55	14.93	-1.63	283.67	14.18	-1.81	308.44	15.42	-1.48
2021	293.59	14.68	-1.66	278.39	13.92	-1.86	303.78	15.19	-1.51
2022	288.83	14.44	-1.62	273.44	13.67	-1.78	299.34	14.97	-1.46
2023	284.10	14.20	-1.64	268.43	13.42	-1.83	294.91	14.75	-1.48
2024	279.72	13.99	-1.54	263.87	13.19	-1.70	290.84	14.54	-1.38
2025	275.39	13.77	-1.55	259.36	12.97	-1.71	286.80	14.34	-1.39
2026	271.14	13.56	-1.54	254.95	12.75	-1.70	282.84	14.14	-1.38
2027	267.00	13.35	-1.53	250.64	12.53	-1.69	278.94	13.95	-1.38
2028	262.94	13.15	-1.52	246.43	12.32	-1.68	275.12	13.76	-1.37
2029	258.94	12.95	-1.52	242.31	12.12	-1.67	271.38	13.57	-1.36
2030	255.01	12.75	-1.52	238.17	11.91	-1.71	267.66	13.38	-1.37
2031	251.03	12.55	-1.56	234.10	11.70	-1.71	263.91	13.20	-1.40
2032	247.16	12.36	-1.54	230.14	11.51	-1.69	260.27	13.01	-1.38
2033	243.36	12.17	-1.54	226.25	11.31	-1.69	256.65	12.83	-1.39
2034	239.56	11.98	-1.56	222.38	11.12	-1.71	253.06	12.65	-1.40
2035	235.39	11.77	-1.74	218.00	10.90	-1.97	249.03	12.45	-1.59
2036	231.65	11.58	-1.59	214.23	10.71	-1.73	245.47	12.27	-1.43
2037	227.99	11.40	-1.58	210.48	10.52	-1.75	241.99	12.10	-1.42
2038	224.45	11.22	-1.55	206.92	10.35	-1.69	238.62	11.93	-1.39
2039	220.75	11.04	-1.65	203.16	10.16	-1.82	235.04	11.75	-1.50
2040	217.15	10.86	-1.63	199.56	9.98	-1.77	231.59	11.58	-1.47
2041	213.66	10.68	-1.61	196.07	9.80	-1.75	228.21	11.41	-1.46
2042	210.09	10.50	-1.67	192.46	9.62	-1.84	224.74	11.24	-1.52

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 2003		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
1999	435.00	21.75	-6.45	435.00	21.75	-6.45	435.00	21.75	-6.45
2000	430.00	21.50	-1.15	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	419.00	20.95	-2.56	419.00	20.95	-2.56	419.00	20.95	-2.56
2002	402.96	20.15	-3.83	397.16	19.86	-5.21	402.97	20.15	-3.83
2003	391.85	19.59	-2.76	381.04	19.05	-4.06	348.18	17.41	-13.59
2004	385.27	19.26	-1.68	373.89	18.69	-1.88	323.21	16.16	-7.17
2005	380.68	19.03	-1.19	368.40	18.42	-1.47	319.37	15.97	-1.19
2006	375.67	18.78	-1.32	362.12	18.11	-1.71	315.19	15.76	-1.31
2007	370.50	18.53	-1.38	355.37	17.77	-1.86	310.87	15.54	-1.37
2008	365.00	18.25	-1.48	348.12	17.41	-2.04	306.14	15.31	-1.52
2009	358.90	17.95	-1.67	340.25	17.01	-2.26	301.03	15.05	-1.67
2010	353.27	17.66	-1.57	333.21	16.66	-2.07	296.30	14.82	-1.57
2011	347.65	17.38	-1.59	326.27	16.31	-2.08	291.59	14.58	-1.59
2012	341.81	17.09	-1.68	319.23	15.96	-2.16	286.69	14.33	-1.68
2013	335.90	16.79	-1.73	312.20	15.61	-2.2	281.73	14.09	-1.73
2014	329.95	16.50	-1.77	304.99	15.25	-2.31	276.74	13.84	-1.77
2015	324.71	16.24	-1.59	298.98	14.95	-1.97	272.34	13.62	-1.59
2016	319.48	15.97	-1.61	292.83	14.64	-2.06	267.96	13.40	-1.61
2017	314.11	15.71	-1.68	286.62	14.33	-2.12	263.46	13.17	-1.68
2018	308.83	15.44	-1.68	280.57	14.03	-2.11	259.06	12.95	-1.67
2019	303.49	15.17	-1.73	274.48	13.72	-2.17	254.58	12.73	-1.73
2020	298.55	14.93	-1.63	269.02	13.45	-1.99	250.43	12.52	-1.63
2021	293.59	14.68	-1.66	263.42	13.17	-2.08	246.27	12.31	-1.66
2022	288.83	14.44	-1.62	258.23	12.91	-1.97	242.28	12.11	-1.62
2023	284.10	14.20	-1.64	252.94	12.65	-2.05	238.31	11.92	-1.64
2024	279.72	13.99	-1.54	248.18	12.41	-1.88	234.64	11.73	-1.54
2025	275.39	13.77	-1.55	243.49	12.17	-1.89	231.00	11.55	-1.55
2026	271.14	13.56	-1.54	238.92	11.95	-1.88	227.44	11.37	-1.54
2027	267.00	13.35	-1.53	234.45	11.72	-1.87	223.96	11.20	-1.53
2028	262.94	13.15	-1.52	230.11	11.51	-1.85	220.56	11.03	-1.52
2029	258.94	12.95	-1.52	225.85	11.29	-1.85	217.21	10.86	-1.52
2030	255.01	12.75	-1.52	221.54	11.08	-1.91	213.90	10.70	-1.52
2031	251.03	12.55	-1.56	217.38	10.87	-1.88	210.57	10.53	-1.56
2032	247.16	12.36	-1.54	213.33	10.67	-1.86	207.32	10.37	-1.54
2033	243.36	12.17	-1.54	209.36	10.47	-1.86	204.13	10.21	-1.54
2034	239.56	11.98	-1.56	205.45	10.27	-1.87	200.95	10.05	-1.56
2035	235.39	11.77	-1.74	200.89	10.04	-2.22	197.45	9.87	-1.74
2036	231.65	11.58	-1.59	197.07	9.85	-1.9	194.31	9.72	-1.59
2037	227.99	11.40	-1.58	193.27	9.66	-1.93	191.24	9.56	-1.58
2038	224.45	11.22	-1.55	189.69	9.48	-1.85	188.28	9.41	-1.55
2039	220.75	11.04	-1.65	185.88	9.29	-2.01	185.17	9.26	-1.65
2040	217.15	10.86	-1.63	182.29	9.11	-1.93	182.15	9.11	-1.63
2041	213.66	10.68	-1.61	178.81	8.94	-1.91	179.22	8.96	-1.61
2042	210.09	10.50	-1.67	175.20	8.76	-2.02	176.23	8.81	-1.67

Alternative Constant Rate Decline Projections of Total U.S. Cigarette Consumption

Year	3.5% Decline Per Year			4.0% Decline Per Year		
	Cigarettes (billions)	*Packs (billions)*	*Growth Rate (%)*	*Cigarettes (billions)*	*Packs (billions)*	*Growth Rate (%)*
1999	435.00	21.75		435.00	21.75	
2000	430.00	21.50	-1.15	430.00	21.50	-1.15
2001	414.95	20.75	-3.50	412.80	20.64	-4.00
2002	400.43	20.02	-3.50	396.29	19.81	-4.00
2003	386.41	19.32	-3.50	380.44	19.02	-4.00
2004	372.89	18.64	-3.50	365.22	18.26	-4.00
2005	359.84	17.99	-3.50	350.61	17.53	-4.00
2006	347.24	17.36	-3.50	336.59	16.83	-4.00
2007	335.09	16.75	-3.50	323.12	16.16	-4.00
2008	323.36	16.17	-3.50	310.20	15.51	-4.00
2009	312.04	15.60	-3.50	297.79	14.89	-4.00
2010	301.12	15.06	-3.50	285.88	14.29	-4.00
2011	290.58	14.53	-3.50	274.44	13.72	-4.00
2012	280.41	14.02	-3.50	263.47	13.17	-4.00
2013	270.60	13.53	-3.50	252.93	12.65	-4.00
2014	261.13	13.06	-3.50	242.81	12.14	-4.00
2015	251.99	12.60	-3.50	233.10	11.65	-4.00
2016	243.17	12.16	-3.50	223.77	11.19	-4.00
2017	234.66	11.73	-3.50	214.82	10.74	-4.00
2018	226.44	11.32	-3.50	206.23	10.31	-4.00
2019	218.52	10.93	-3.50	197.98	9.90	-4.00
2020	210.87	10.54	-3.50	190.06	9.50	-4.00
2021	203.49	10.17	-3.50	182.46	9.12	-4.00
2022	196.37	9.82	-3.50	175.16	8.76	-4.00
2023	189.49	9.47	-3.50	168.15	8.41	-4.00
2024	182.86	9.14	-3.50	161.43	8.07	-4.00
2025	176.46	8.82	-3.50	154.97	7.75	-4.00
2026	170.29	8.51	-3.50	148.77	7.44	-4.00
2027	164.33	8.22	-3.50	142.82	7.14	-4.00
2028	158.57	7.93	-3.50	137.11	6.86	-4.00
2029	153.02	7.65	-3.50	131.62	6.58	-4.00
2030	147.67	7.38	-3.50	126.36	6.32	-4.00
2031	142.50	7.13	-3.50	121.30	6.07	-4.00
2032	137.51	6.88	-3.50	116.45	5.82	-4.00
2033	132.70	6.63	-3.50	111.79	5.59	-4.00
2034	128.06	6.40	-3.50	107.32	5.37	-4.00
2035	123.57	6.18	-3.50	103.03	5.15	-4.00
2036	119.25	5.96	-3.50	98.91	4.95	-4.00
2037	115.07	5.75	-3.50	94.95	4.75	-4.00
2038	111.05	5.55	-3.50	91.15	4.56	-4.00
2039	107.16	5.36	-3.50	87.51	4.38	-4.00
2040	103.41	5.17	-3.50	84.01	4.20	-4.00
2041	99.79	4.99	-3.50	80.65	4.03	-4.00
2042	96.30	4.81	-3.50	77.42	3.87	-4.00

Appendix 1: Raw Data Reference

Mnemonic	Label	Time Frame	Source
ADV	Advertising and Promotional Expenditures, Millions of Dollars	1963-1999	Federal Trade Commission Report to Congress for ‘90, ‘91, ‘92, ‘93, ’96, 97, ’98, ‘99
CIGPRICE	Real Tobacco Consumer Price Index	1947-1999	DRI•WEFA Calculation: CPITOB/CPIU = CIGPRICE
CPC	Adult Per Capita Consumption, Cigarettes	1945-1999	Tobacco Situation and Outlook Report, USDA’s Economic Research Service, various issues
CPITOB	Consumer Price Index, Tobacco 1982/1984 = 100	1947-1999	Bureau of Labor Statistics
CPIU	Consumer Price Index, All Items	1947-1999	Bureau of Labor Statistics
NP	Total Population, Millions	1946-1999	BEA, NIPA
NP16A	Total Population, Above 16, Millions	1946-1999	BUREAU OF THE CENSUS
NPTF1617	Total Population, Female 16-17, Millions	1946-1999	BUREAU OF THE CENSUS
NPTM1617	Total Population, Male 16-17, Millions	1946-1999	BUREAU OF THE CENSUS
NP18A	Total Population, Above 18, Millions	1946-1999	DRI•WEFA Calculation: NP16A - (NPTF1617 + NPTM1617)
SMOKEBAN	Dummy Variable that Captures the Effect of the Bans on Smoking in Public Places from the 1980’s to the 1990’s	1965-1998	DRI•WEFA
RADVPC	Real Per Capita Advertising Expenditures	1960-1997	DRI•WEFA Calculation: [(YDP96 x 100) / CPIU] / NP = RADVPC
TEENPER	Incidence of First Daily Use of Cigarettes, Ages 12-17, Percentage	1965-1997	Center for Disease Control and Prevention, Substance Abuse and Mental Health Services Admin., National Household Survey on Drug Abuse for 1998
TOTALCIGC	Total Consumption, Billions of Cigarettes	1945-1999	Publications and reports of the U.S. Department of Treasury's Bureau of Alcohol, Tobacco, and Firearms, and the Internal Revenue

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APPENDIX B

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection

Exhibit A hereto, or 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.

(f) "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 last 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).

(g) "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.

(h) "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.

(i) "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 approved sanctioning 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 athletic 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.

(j) "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.

(k) "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.

(l) "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), 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(m) "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.

(n) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(o) "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.

(p) "Escrow" has the meaning given in the Escrow Agreement.

(q) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(r) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(s) "Federal Tobacco Legislation Offset" means the offset described in section X.

(t) "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 (t), "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.

(u) "Foundation" means the foundation described in section VI.

(v) "Independent Auditor" means the firm described in subsection XI(b).

(w) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(x) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(y) "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.

(z) "MSA Execution Date" means November 23, 1998.

(aa) "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.

(bb) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(cc) "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.

(dd) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ee) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(ff) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(gg) "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.

(hh) "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 or at the location of any retail establishment that sells Tobacco Products (other than solely through a vending machine) or (B) outside any such establishment on the property of any such establishment or (C) on the inside surface of a window facing located 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 successor 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

[illegible]

III. PERMANENT RELIEF

[illegible]

(c) Prohibition of Tobacco Brand Name Sponsorships [illegible]

[illegible]

[illegible]

(d) Ban on Youth Access to Free Samples. [illegible]

(e) Ban on Gifts to Underage Persons Based on Proofs of Purchase. [illegible]

(f) Limitation on Third-Party Use of Brand Names. [illegible]

(g) Ban on Non-Tobacco Brand Names. [illegible]

(h) Minimum Pack Size of Twenty Cigarettes. [illegible]

(i) Corporate Culture Commitments Related to Youth Access and Consumption. [illegible]

[illegible]

[illegible]

[illegible]

(m) Limitations on Lobbying Following State-Specific Finality in a Settling State.

(1) [illegible]

(2) [illegible]

(3) [illegible]

(4) [illegible]

[illegible]

(5) [illegible]

(6) [illegible]

(n) Dissolution of the Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) [illegible]

(2) [illegible]

in accordance with the laws of the State of New York and under the oversight of the Attorney General of the State of New York, and with the preservation of all applicable privileges held by any member company of CIAR.

(2) 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).

(3) 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.

(4) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(5) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (4) 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 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 purposes 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 written or oral) 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 earlier 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 lawsuits 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 90 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, each 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 3 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 Internet, but each Original Participating Manufacturer and Tobacco-Related Organization 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, Minnesota).

(d) Each Original Participating Manufacturer will provide indexing and other features to improve searchable access to the document images on its website as set forth in Exhibit I.

(e) 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(d) 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.

(f) The expenses incurred pursuant to subsection IV(e), 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 such contributions 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 to subsection IX(e) and monies received in the form of 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 rates and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(i) below, or is a political subdivision in such a Settling State.

(b) 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.

(c) 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 XV(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 XV(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 [illegible]), 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 each 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 D, 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 Releasing 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 D, 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 XV(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 each 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 VII(g)(1) 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 accept 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 following the applicable date. Funds under this subsection VIII(b)

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund" or the "Fund") in the form attached as Exhibit [illegible], which will be maintained by each Settling State: (1) to enforce, and implement 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 Payment 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 (b)(1)) 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 payment amounts due from 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 derived on the basis 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)(1)(E) 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 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 (1)(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 event, the 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.

(iii) 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 (1) 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 (2) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of (x) its Base NPM Adjustment for such year, and (y) the amount allocated to such Original Participating Manufacturer pursuant to clause (1).

(iv) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(1)(C)(ii) or IX(d)(1)(C)(iii) 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.

(D) Adjustments.

(i) For calculations made pursuant to this subsection IX(d)(1) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(1)(A)(ii)(x) shall be 52 and the number used in subsection IX(d)(1)(A)(ii)(y) shall be $400 million. Each year thereafter, both such 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 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 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)).

(E) 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 IX(d)(1)(E), "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 subsection IX(d)(1)(C) shall be further reallocated between Lorillard and Philip Morris as follows (subsection IX(d)(1)(E) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsection IX(d)(1)(C) of this subsection IX(d)(1), but subject to further adjustment pursuant to subsections IX(d)(1)(E)(ii) and IX(d)(1)(E)(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 Lorillard would be entitled to in the same year pursuant to subsection IX(d)(1)(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 subsection IX(d)(1)(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), then Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(1)(E)(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) 5.0000000% 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 IX(d)(1)(E)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

(iii) In the event that in any year a reallocation of the share of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to subsection IX(d)(1)(E)(i) 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 subsection IX(d)(1)(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)(1) pursuant to subsection IX(d)(2)(D), this subsection IX(d)(1)(E) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsection IX(d)(1)(C).

(2) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(j)(1), 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 IX(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 IX(d)(1)(B) 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 Shares to be those 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 VI(c) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payment amount is 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 and revenues derived from, the manufacture and sale in the United 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 IX(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)(2); (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 each 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 had 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 subsection (a) 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 would have received.

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)(1)) shall be based on the 1998 Relative Market Shares of the Original Participating Manufacturers or, if the Original Participating Manufacturers are unable to agree on such Relative Market Shares, on their 1997 Relative Market Shares specified in Exhibit Q.

(b) Identity of Independent Auditor. The Independent Auditor shall be a major, nationally recognized, certified public accounting firm jointly selected by agreement of the Original Participating Manufacturers and those Attorneys General of the Settling States who are members of the NAAG executive committee, who shall jointly retain the power to replace the Independent Auditor and appoint its successor. Fifty percent of the costs and fees of the Independent Auditor (but in no event more than $500,000 per annum), shall be paid by the Fund described in Exhibit J hereto, and the balance of such costs and fees shall be paid by the Original Participating Manufacturers, allocated among them according to their Relative Market Shares. The agreement retaining the Independent Auditor shall provide that the Independent Auditor shall perform the functions specified for it in this Agreement, and that it shall do so in the manner specified in this Agreement.

(c) Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the dispute shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

(d) General Provisions as to Calculation of Payments.

(1) Not less than 90 days prior to the scheduled due date of any payment due pursuant to this Agreement ("Payment Due Date"), the Independent Auditor shall deliver to each other Notice Party a detailed itemization of all information required by the Independent Auditor to complete its calculation of (A) the amount due from each Participating Manufacturer with respect to such payment, and (B) the portion of such amount allocable to each entity for whose benefit such payment is to be made. To the extent practicable, the Independent Auditor shall specify in such itemization which Notice Party is requested to produce which information. Each Participating Manufacturer and each Settling State shall use its best efforts to promptly supply all of the required information that is within its possession or is readily available to it to the Independent Auditor, and in any event not less than 50 days prior to such Payment Due Date. Such best efforts obligation shall be continuing in the case of information that comes within the possession of, or becomes readily available to, any Settling State or Participating Manufacturer after the date 50 days prior to such Payment Due Date.

(2) Not less than 40 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party (A) detailed preliminary calculations ("Preliminary Calculations") of the amount due from each Participating Manufacturer and of the amount allocable to each entity for whose benefit such payment is to be made, showing all applicable offsets, adjustments, reductions and carry-forwards and setting forth all the information on which the Independent Auditor relied in preparing such Preliminary Calculations, and (B) a statement of any information still required by the Independent Auditor to complete its calculations.

(3) Not less than 30 days prior to the Payment Due Date, any Participating Manufacturer or any Settling State that disputes any aspect of the Preliminary Calculations (including, but not limited to, disputing the methodology that the Independent Auditor employed, or the information on which the Independent Auditor relied, in preparing such calculations) shall notify each other Notice Party of such dispute, including the reasons and basis therefor.

(4) Not less than 15 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party a detailed recalculation (a "Final Calculation") of the amount due from each Participating Manufacturer, the amount allocable to each entity for whose benefit such payment is to be made, and the Account to which such payment is to be credited, explaining any changes from the Preliminary Calculation. The Final Calculation may include estimates of amounts in the circumstances described in subsection (d)(5).

(5) The following provisions shall govern in the event that the information required by the Independent Auditor to complete its calculations is not in its possession by the date as of which the Independent Auditor is required to provide either a Preliminary Calculation or a Final Calculation:

(A) If the information in question is not readily available to any Settling State, any Original Participating Manufacturer or any Subsequent Participating Manufacturer, the Independent Auditor shall employ an assumption as to the missing information producing the minimum amount that is likely to be due with respect to the payment in question, and shall set forth its assumption as to the missing information in its Preliminary Calculation or Final Calculation, whichever is at issue. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State may dispute any such assumption employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or any such assumption employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the missing information becomes available to the Independent Auditor prior to the Payment Due Date, the Independent Auditor shall promptly revise its Preliminary Calculation or Final Calculation (whichever is applicable) and shall promptly provide the revised calculation to each Notice Party, showing the newly available information. If the missing information does not become available to the Independent Auditor prior to the Payment Due Date, the minimum amount calculated by the Independent Auditor pursuant to this subsection (A) shall be paid on the Payment Due Date, subject to disputes pursuant to subsections (d)(6) and (d)(8) and without prejudice to a later final determination of the correct amount. If the missing information becomes available to the Independent Auditor after the Payment Due Date, the Independent Auditor shall calculate the correct amount of the payment in question and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(B) If the information in question is readily available to a Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer, but such Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer does not supply such information to the Independent Auditor, the Independent Auditor shall base the calculation in question on its best estimate of such information, and shall show such estimate in its Preliminary Calculation or Final Calculation, whichever is applicable. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State (except the entity that withheld the information) may dispute such estimate employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or such estimate employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the withheld information is not made available to the Independent Auditor more than 30 days prior to the Payment Due Date, the estimate employed by the Independent Auditor (as revised by the Independent Auditor in light of any dispute filed pursuant to the preceding sentence) shall govern the amounts to be paid on the Payment Due Date, subject to disputes pursuant to subsection (d)(8) 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 (d)(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 (d)(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) Since 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 (X)(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 after the 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 VI(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 VI(h)(2), 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 (f)(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 VI(h)(2), 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 (f)(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 (f)(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 (f)(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 contributions 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

[illegible]

(4) [illegible] Settling State. [illegible]

(c) Payments to be Made Only After Final Approval. [illegible]

(d) Applicability to Section XVII Payments. [illegible]

(i) [illegible] Payments.

(1) Underpayments.

(A) [illegible]

[illegible]

(2) Overpayments.

(A) [illegible]

(B) [illegible]

(C) [illegible]

(D) [illegible]

(E) [illegible]

(F) [illegible]

(j) Payments After Applicable Condition. [illegible]

[illegible]

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 [illegible] 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 action.

(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) [illegible] any and all liability of any Original Participating Manufacturer [illegible] Released Party by virtue of its relationship with any Original Participating Manufacturer [illegible] whether on a claim-over or an express written indemnity agreement [illegible]

[illegible]

[illegible] the Litigating Releasing Parties Offset; (ii) the offset [illegible] Original Participating Manufacturer [illegible] full amount of such Original Participating Manufacturer's share of such Allocated Payment, and (iii) all [illegible] following year(s) [illegible] has been effected.

(C) Each Settling State further agrees that, subject to the provisions of subsection [illegible], each Subsequent Participating Manufacturer shall be [illegible] any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer [illegible] Original Participating Manufacturer.

(D) 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 State's ability to enforce the Consent Decree [illegible] pursuant to the terms thereof. Provided, however, that neither subsection [illegible] of this Agreement nor subsection V(A) or V(I) of the Consent Decree shall [illegible] MSA Execution Date [illegible] MSA Execution Date.

(5) The Settling States do not purport to waive or release any claims on behalf of Indian tribes.

(6) The Settling States do not waive or release any criminal liability based on federal, state or local law.

(7) Notwithstanding the foregoing (and the definition of Released Claims), 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.

(8)(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 to any person or entity that is a Released Party by virtue of its relationship with any Original Participating Manufacturer with respect to claims-over [illegible]

[illegible]

(C) Each Settling State further agrees that, subject to the provisions of subsection [illegible], each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection [illegible] above to the extent that it [illegible] any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer [illegible] 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 his favor at the time of executing the release, which if known by him must have materially affected his 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 proviso in [illegible] Attorney General to release such person's or entity's claims) asserts or 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 [illegible] days of receiving notice of such potential claim (or within 30 days after the MSA Execution Date, whichever is later) [illegible] 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)(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)(3) or (b)(4) below if such Released Party failed to take ordinary and reasonable measures to defend the action fully.

(5) The following provisions shall apply where the Releasee Party is an Original Participating Manufacturer (or any person or entity that is a Releasee Party by virtue of its relationship with an Original Participating Manufacturer):

(A) In the event of a settlement or unsatisfied judgment, the settlement or unsatisfied amount shall give rise to an offsetting credit 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 each time, until the settlement or judgment amount is fully credited on a dollar-for-dollar basis.

(B) A judgment (other than a default judgment) against a Releasee 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 (a)(5) 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 (5) 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.

(6) The following provisions shall apply where the Releasee Party is a Subsequent Participating Manufacturer (or any person or entity that is a Releasee Party by virtue of its relationship with a Subsequent Participating Manufacturer): Subject to the provisions of subsection IX(i), each Subsequent Participating Manufacturer shall be entitled to the offset as provided in subsection XII(a)(5) above against payments it otherwise would owe under section IX(i) to the extent that any person or entity that is a Releasor Party by virtue of its relationship with such Subsequent Participating Manufacturer has paid on a settlement, unsatisfied judgment or judgment that would give rise to an offset under such provision if paid by an Original Participating Manufacturer.

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

(a) Within 10 days after the MSA Execution Date (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit), each Settling State and each Participating Manufacturer that is a party in any of the lawsuits identified in Exhibit D shall jointly move for a stay of all proceedings in such Settling State's lawsuit with respect to the Participating Manufacturers and all other Released Parties (except any proceeding seeking public disclosure of documents pursuant to subsection IV(b)). Such stay of a Settling State's lawsuit shall be dissolved upon the earlier of the occurrence of State-Specific Finality or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Not later than December 11, 1998 (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit):

(1) each Settling State that is a party to a lawsuit identified in Exhibit D and each Participating Manufacturer will:

(A) tender this Agreement to the Court in such Settling State for its approval; and

(B) tender to the Court in such Settling State for entry a consent decree conforming to the model consent decree attached hereto as Exhibit L (revisions or changes to such model consent decree shall be limited to the extent required by state procedural requirements to reflect accurately the factual setting of the case in question, but shall not include any substantive revision to the duties or obligations of any Settling State or Participating Manufacturer, except by agreement of all Original Participating Manufacturers); and

(2) each Settling State shall seek entry of an order of dismissal of claims dismissing with prejudice all claims against the Participating Manufacturers and any other Released Party in such Settling State's action identified in Exhibit D. Provided, however, that the Settling State is not required to seek entry of such an order in such Settling State's action against such a Released Party (other than a Participating Manufacturer) unless and until such Released Party has released the Releasing Parties (and delivered to the Attorney General of such Settling State a copy of such release) (which release shall be effective upon the occurrence of State-Specific Finality in such Settling State, and shall recite that in the event this Agreement is terminated with respect to such Settling State pursuant to subsection XVIII(u)(1) the Released Party agrees that the order of dismissal shall be null and void and of no effect) from any and all Claims of such Released Party relating to the prosecution of such action as provided in subsection XII(a)(2).

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

(a) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will dismiss without prejudice (and without costs and fees) the lawsuit(s) listed in Exhibit M pending in such Settling State in which the Participating Manufacturer is a plaintiff. Within 10 days after the MSA Execution Date, each Participating Manufacturer and each Settling State that is a party in any of the lawsuits listed in Exhibit M shall jointly move for a stay of all proceedings in such lawsuit. Such stay of a lawsuit against a Settling State shall be dissolved upon the earlier of the occurrence of State-Specific Finality in such Settling State or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Upon State-Specific Finality in any 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 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 shall 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 ("Litigating Political Subdivision"); and (3) the appropriate agencies of such Settling State and such Litigating Political Subdivisions, 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

[illegible]

XVIII. MISCELLANEOUS

(a) [illegible]

(b) [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

(c) [illegible] Transfer of Tobacco Brands. [illegible]

(d) Payments in Settlement. [illegible]

(e) No Determination or Admission. [illegible]

(f) Non-Admissibility. [illegible]

(g) Representations of Parties. [illegible]

(h) Obligations Several, Not Joint. [illegible]

(l) 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.

(m) 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.

(n) Notices. All notices or other communications to any party to this Agreement shall be in writing (including, but not limited to, telex, telefacsimile 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.

(o) 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 secure State-Specific Finality of this Agreement as to such Settling State.

(p) 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.

(q) 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.

(r) Severability.

(1) Sections III, VI, IX, X, XI, XII, XIII, XIV, XV, XVI, XVIII(c), (d), (e), (f), (l), (m), (n), (o), (r), (s), (t), (u), (w), (z), (aa), (bb) and Exhibits A, B, and E [illegible] ("Nonseverable Provisions") are not severable, except to the extent that severance of [illegible] is permitted by the Settling States pursuant to subsection (r)(2) 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 invalid 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 invalid 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 alter 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 invalid 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 (r)(2) or (r)(3) hereof, whichever is applicable.

(s) 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.

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

(u) 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 (u) shall not be construed as extending the territorial scope of any obligation or duty set forth herein if such scope is otherwise limited by the terms hereof.

(v) 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.

(w) 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.

(x) 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(r) 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.

(y) 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.

(z) 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 the 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 (z)(2) 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 (and/or 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 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);

(2) 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);

(3) 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 exception to the automatic stay set forth in section 362(b)(4) 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

(4) to the extent that any Settling State is pursuing a police and regulatory action against such Participating Manufacturer as described in subsection (3), such Participating Manufacturer shall not seek or support a request that the Bankruptcy Court exercise its authority provided under section 105 of the Bankruptcy Code to enjoin a Settling State's action. The Participating Manufacturers further agree that they will not oppose, 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 non-opposition to requests [illegible] initiated by another.

(C) Subsequent to the Settling States' [illegible] (A) and (B) above:

(i) 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 that 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)(B)), but such Participating Manufacturer's Market Share shall not be included in that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(d) 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); and (ii) for purposes of subsection IX(d)(1) of Exhibit F, 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. For purposes of subsection IX(d)(1), 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 acquirer 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 not as to any action that by the express terms of this Agreement requires the unanimous agreement of all Original Participating Manufacturers.

(ii) 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), 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)(B)), but such Participating Manufacturer's Market Share shall not be included in that of a Participating Manufacturer for the purpose of determining whether the trigger percentage specified in subsection IX(d) 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 (ii) for purposes of subsection IX(d)(1), 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 acquirer 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).

(D) The payment of any Agreement pursuant to subsection XVIII(k)(C) shall not be required by virtue of any resolution or an avoidance claim in the Bankruptcy of Claims against the Bankrupt Participating Manufacturer.

(l) 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.

(m) 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.

(n) 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.

(o) 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.

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

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

(r) 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 on or 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.

(s) 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.

(t) 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.

(u) 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.

[Signature Pages to Follow]

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.	0.6472150%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6010329%
Idaho	0.3632585%
Illinois	4.6536131%
Indiana	2.0398310%
Iowa	0.8696189%
Kansas	0.8336712%
Kentucky	1.7611538%
Louisiana	2.2553135%
Maine	0.7693050%
Maryland	2.2636596%
Massachusetts	4.0389790%
Michigan	4.3507038%
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	5.0377567%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.9714337%
South Carolina	1.1669346%
South Dakota	0.3499818%
Tennessee	2.4468072%
Texas	0.0000000%
Utah	0.4419089%
Vermont	0.4815124%
Virginia	2.0480110%
Washington	2.0625118%
West Virginia	0.8970915%
Wisconsin	2.0399271%
Wyoming	0.2483449%
American Samoa	0.0152590%
N. Mariana Islands	0.0136403%
Guam	0.0189257%
U.S. Virgin Islands	0.0168144%
Puerto Rico	1.1123714%
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 meanings 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 [illegible]
[illegible]

(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 (1) written instructions from the Independent Auditor or (2) 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 (2) shall govern over instructions pursuant to clause (1).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Escrow 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 received 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 parties hereto, 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 Settling State and each Participating Manufacturer a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. Limitation of Escrow Agent's Reliance on Instructions.

In the event that the Escrow Agent's responsibilities are not clearly covered by the 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 until it has received written instructions as required 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 maintaining a AAA rating by the Standard & Poor's rating service or the equivalent 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 undivided profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undivided profits in excess of $100,000,000. 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. All securities 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 to or charged against, as the case may be, 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 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 consistent 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 otherwise certify that it is exempt from backup withholding, and in the case of the disbursement of funds, a completed Form W-9 indicating the recipient 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-2(k) and (l), and any amendments to such regulation.

SECTION 7. Rights 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's 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 or other communications to any party to this Escrow Agreement or to any other person hereunder shall be given in the same manner as, shall be given to the same persons 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 Account(s) any amounts payable from any Account to satisfy any funding 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 person or entity 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 this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments. As to payments to be made under this Escrow Agreement, the Settling States shall be the beneficiaries of such payments and not recipients of 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 of Settling States, the Escrow Agent and each Participating Manufacturer shall be permitted to assign its interest to its successor entity whatsoever.

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; 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 a written instrument executed by all of the parties hereto and shall be attested to by the signatories. 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 such counterpart execution, an original executed Escrow Agreement shall 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. Execution and Effectiveness.

This Escrow Agreement shall become effective on the date 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 this 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 23. *Address for Payment.*

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 party 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 24. *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 above written.

(Signature Block)

Appendix A

Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING INFLATION ADJUSTMENTS

(A) [illegible]

(B) [illegible]

(C) [illegible]

(D) [illegible]

(E) [illegible]

(F) [illegible]

(G) Additional Examples.

(1) Calculating the Inflation Adjustment Percentages:

Year Payment Due	CPI%	Percentage by which prior year's Inflation Adjustment Percentage is increased (the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	[illegible]	[illegible]	[illegible]
2001	[illegible]	[illegible]	[illegible]
2002	[illegible]	[illegible]	[illegible]
2003	[illegible]	[illegible]	[illegible]
2004	[illegible]	[illegible]	[illegible]
2005	[illegible]	[illegible]	[illegible]
2006	[illegible]	[illegible]	[illegible]

(2) Applying the Inflation Adjustment:

[illegible]

[illegible]

[illegible]

[illegible]

EXHIBIT D
LIST OF LAWSUITS

1 Alabama
[illegible]

2 Alaska
[illegible]

3 Arizona
[illegible]

4 Arkansas
[illegible]

5 California
[illegible]

6 Colorado
[illegible]

7 Connecticut
[illegible]

8 Delaware
[illegible]

9 District of Columbia
[illegible]

10 Georgia
[illegible]

11 Hawaii
[illegible]

12 Idaho
[illegible]

13 Illinois
[illegible]

14 Indiana
[illegible]

15 Iowa
[illegible]

16 Kansas
[illegible]

17 Kentucky
[illegible]

18 Louisiana
[illegible]

19 Maine
[illegible]

20 Maryland
[illegible]

21 Massachusetts
[illegible]

Michigan
[illegible]

Minnesota
[illegible]

Missouri
[illegible]

Montana
[illegible]

Nebraska
[illegible]

27. **Nevada**
State of Nevada v. Philip Morris Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

28. **New Hampshire**
New Hampshire v. R.J. Reynolds Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-0165 (N.H.)

29. **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.)

30. **New Mexico**
State of New Mexico v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF 97-1235 (N.M.)

31. **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.)

32. **Ohio**
State of Ohio v. Philip Morris Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH05-5114 (Ohio)

33. **Oklahoma**
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

34. **Oregon**
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

35. **Pennsylvania**
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

36. **Puerto Rico**
Rosselló, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

37. **Rhode Island**
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

38. **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.)

39. **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.)

40. **Utah**
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96-CV-0829W (Utah)

41. **Vermont**
State of Vermont v. Philip Morris Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 [illegible] (Vt.)

42. **Washington**
State of Washington v. American Tobacco Co., Inc., et al., Superior Court of Washington, King County, No. 96-2-15056-8SEA (Wash.)

43. **West Virginia**
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-C-1707 (W. Va.)

44. **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 specified by the terms of the Master Settlement Agreement 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 below) (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 such amount an amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (1) 1 (one) minus (2) 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, and 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, 1998 to be applied for each year after 1998), 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) 1.25 of the 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 (before product liability payments, restructuring charges and settlement-related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes, and [illegible] 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 include 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 1998.

iii. Any recovery of 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 1998 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1998 to be applied for each year after 1998); 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 final approval of the plan of dissolution, the Tobacco Institute ("TI") shall:

(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 whom TI [illegible] needed for the sole purpose of directing and supporting TI's defense of ongoing litigation, or is reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's ("the TITL") [illegible] testing pursuant to the Federal Trade Commission ("the FTC") [illegible] or any other testing protocol by the FTC or federal law, as set forth in section (b) below.

(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, or by some other mechanism, which shall be established within 90 days of court approval of the plan of dissolution. An opinion letter shall 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 as soon as possible under the terms of the leases, provided, however, that TI may retain or lease some such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for ongoing TI litigation defense activities [illegible] of this Agreement. TI shall provide notice to each of its landlords of its desire to terminate its lease with such landlord, and shall request that the landlord take all steps to facilitate the premises' re-letting [illegible] TI shall vacate such leasehold premises as soon as they are no longer needed for the [illegible].

(b) Accountability. Within 90 days after court approval of a plan of dissolution, TI shall provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, [illegible] claims of state and federal governments against it, [illegible] claims against it, pending litigation in which it is a party and [illegible].

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ [illegible], TI shall provide a copy of all [illegible] made available to the State of New York in discovery [illegible] 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") [illegible] of privilege claims pursuant to [illegible] in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-[illegible] (Dist. Ct., Cleveland County) (the "Oklahoma action").

(1) TI shall 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 written request by the Attorney General, TI shall also make available a copy of the privilege log, if any, such [illegible].

(2) The depository of any documents [illegible] claimed to be privileged will be governed by section [illegible] of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI shall 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 it made [illegible] have been made available to the Attorney General.

(d) Remaining Assets. [illegible] between TI and the Attorney General of New York [illegible] health or child welfare organization will be [illegible] after lawful transfer of assets and satisfaction of TI's [illegible] benefit obligations and any [illegible] liabilities [illegible].

(e) Defense of Litigation. Pursuant to Section [illegible] of the New York Not-for-Profit Corporation Law, TI shall 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 may be brought or threatened in the future. TI shall retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, [illegible] privileged communications and [illegible] privileged documents, filing pleadings, responding to discovery requests, motions, [illegible] filing affidavits and briefs, conducting party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending trial or trials, [illegible] any claims asserted against it, [illegible] deems significant to its defense, and whether to discharge or [illegible] its defense. Pursuant to existing joint defense agreements, TI may continue to [illegible] joint 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. At such time as TI has no litigation pending against it, it shall dissolve completely and will do so in accordance with the requirements of law.

(d) No public statements. Except as necessary in the course of litigation defense or as required by section (c) 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.

(e) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than the defense of litigation as described in section (c) 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 its wind-down efforts and work remaining to be done with respect to such efforts.

(f) FTC. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform FTC cigarette testing pursuant to the FTC method or any other testing method required 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.

(g) 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 (c) above.

(h) 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.

(i) 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 the court makes any material change to any term or provision of the plan of dissolution agreed upon and presented to it 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 obligation or covenant imposed 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 terms or scope 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. LX-816-3 (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. Pa.)

(d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-C-4486 (N.D. Ill.)

(e) The FTC investigation 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 956
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 possessed or produced 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 Cty)

(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. C1-94-8565 (Minn. Dist. Ct., County of Ramsey)

(f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (Fla. Dist. 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 or, in its discretion, a combined, 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 form that can be incorporated into such indices:

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	Standard 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 Organization will provide, at its own expense, to NAAG a copy in an electronic format of its website document images and its accompanying subsection (b)(1) index as ASCII-delimited flat files of 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 copies.

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, duly named 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 of any other monies to the extent they are lawfully designated 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 below. 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 act in only one 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: (A) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monitoring costs of the Independent Auditor as contemplated by the Agreement; and (B) 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 disbursements from the fund associated with a Qualifying Action ("Grant Applications").

Section B

Administrative Standards Relating to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay the 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 receipts and grants 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 instruments. The Fund shall be regularly reported on NAAG's 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 purposes of a Qualifying Action and whether and in what amount 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 Applicant as expeditiously as practicable.

Section 9

The Special Committee may issue a grant from the Fund only where an Attorney General certifies that the moneys will be used in connection with a Qualifying Action to: (A) to investigate and/or litigate suspected violations of the Agreement or any 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 moneys 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 use of the funds which are so 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 moneys received from the Fund in the event the case is successful or is resolved by settlement of a Qualifying Action. In the event that the 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 moneys are granted, the Attorney General(s) receiving moneys 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 moneys received by the Fund pursuant to and in the preceding sections, the Special Committee may deposit in the Fund any other moneys lawfully committed for the general purposes of the Fund as set forth in section A(1) above. For example, the Special Committee may, in its discretion, accept for deposit in the Fund a foundation grant or court-ordered funds for such purposes and on whatever conditions are deemed sufficient so long as the moneys 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 purposes of the Fund. The Special Committee will limit the total amount of grants made to a single state to no more than $100,000.00. The Special Committee will not award a single grant in excess of $100,000.00, unless the grant involves more than one state, in which case, a single grant so made may not exceed more than $100,000.00. The Special Committee may, in its discretion and on a case-by-case basis, decide to waive these limitations if it determines that special circumstances exist. Such waiver, however, shall not be effective unless ratified by a two-thirds majority vote of the NAAG executive committee.

Section C

Grant Application Procedure

Section 1

This Protocol shall be transmitted to each Attorney General within 90 days after the MSA Execution Date. It may not be amended except by recommendation of the NAAG executive committee and majority vote of the Settling States. NAAG will mail to the Settling States copies of any amendments promptly, and will transmit yearly to the Attorneys General a report on 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:

(i) A description of the contemplated pending action, including the scope of the alleged violation and the areas/state regions likely to be affected by the suspected offending conduct.

(ii) A statement whether the action is jointly and concurrently pursued by any other Attorney General or other prosecuting authority.

(iii) A description of the purposes for which the moneys sought will be used.

(iv) The amount requested.

(v) A direction 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 litigation, to one or more Attorneys General's offices designated as a recipient of the moneys.

(vi) A statement that the submitting Attorney General will, to the extent permitted by law, pay back to the Fund all, or as much as is possible, of the moneys received, upon receipt of any monetary recovery obtained in the contemplated/pending litigation or settlement of the action.

(vii) A certification that none of the grant moneys will be used to pay the salaries or ordinary expenses of any regular employees of the office of the applicant(s) and that the grant will be used solely to pay for the stated purpose.

(viii) A certification that an accounting will be provided to NAAG of all moneys received by the applicant(s) by no later than the 30th of June next following any receipt of such moneys.

Section 4

All Grant Applications shall be submitted to the NAAG office at the following address: National Association of Attorneys General, 750 First 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 45 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 annual 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 [illegible] to pay for its administrative costs in performing its duties under this Protocol and the Agreement. The NAAG executive committee may adjust the amount of the administrative fee to reflect changed circumstances.

EXHIBIT K

MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.1000000%
R.J. Reynolds Tobacco Company	6.9999999%
Total	100.0000000%

EXHIBIT L

MODEL CONSENT DECREE

IN THE [XXXXXX] COURT OF THE STATE OF [XXXXXX]
IN AND FOR THE COUNTY OF [XXXXXX]

STATE OF [XXXXXXXXXXXX],
Plaintiff,
v.
[XXXXXXXXXXXXXXX], et al.,
Defendants.

CAUSE NO. XXXXXX

CONSENT DECREE AND FINAL JUDGMENT

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/court].

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, promotion, 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)(3)(B) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(3)(B);

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)(3)(B) 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 subsection III(c)(2)(A) or III(c)(3)(B) 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 written or oral), 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 this 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.

E. No party shall be considered [illegible] the Consent Decree and Final Judgment for the purpose of any [illegible] of the State. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of [illegible] Settling State [illegible] Participating Manufacturers' [illegible] and the Participating Manufacturers shall [illegible].

G. [illegible] Consent Decree and Final Judgment [illegible] Consent Decree and Final Judgment shall [illegible] Consent Decree and Final Judgment [illegible] public [illegible] public [illegible] Settling State [illegible] Participating Manufacturer [illegible] this Consent Decree and Final Judgment.

H. All [illegible] of the Participating Manufacturers [illegible] the Consent Decree and Final Judgment [illegible].

I. The [illegible] Consent Decree and Final Judgment [illegible] Settling State [illegible] Consent Decree and Final Judgment [illegible] the Court.

[illegible] Consent Decree [illegible]

K. [illegible] Consent Decree and Final Judgment [illegible].

VII. FINAL DISPOSITION

A. [illegible] dismissed with prejudice as provided therein.

B. [illegible] the Agreement [illegible] the Court further finds [illegible].

IT IS SO ORDERED, ADJUDGED AND DECREED.

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, [illegible] 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, [illegible] 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, [illegible] United States District Court for the District of Massachusetts.

4. Philip Morris, Inc., et al. v. [illegible], Attorney General of the State of Connecticut, [illegible] United States District Court for the District of Connecticut.

5. Philip Morris, et al. v. [illegible] United States District Court for the District of [illegible].

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. I1997/359
3. County of Los Angeles v. R.J. Reynolds Tobacco Co., et al., San Diego Superior Court, No. 707651
4. The People v. Philip Morris, Inc., et al., San Francisco Superior Court, No. 980864
5. County of Cook v. Philip Morris, Inc., et al., Circuit Court of Cook County, Ill., No. 97-L-4550

EXHIBIT O
MODEL STATE FEE PAYMENT AGREEMENT

This STATE Fee Payment Agreement (the "STATE Fee Payment Agreement") is entered into as of ________, between and among the Original Participating Manufacturers and STATE Outside Counsel (as defined herein), to provide for payment of attorneys' fees pursuant to section XVII of the Master Settlement Agreement (the "Agreement").

WITNESSETH:

WHEREAS, the State of STATE and the Original Participating Manufacturers have entered into the Agreement to settle and resolve with finality all Released Claims against the Released Parties, including the Original Participating Manufacturers, as set forth in the Agreement; and

WHEREAS, Section XVII of the Agreement provides that the Original Participating Manufacturers shall pay reasonable attorneys' fees to those private outside counsel identified in Exhibit S to the Agreement, pursuant to the terms hereof.

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the mutual agreement of the State of STATE and the Original Participating Manufacturers to the terms of the Agreement and of the mutual agreement of STATE Outside Counsel and the Original Participating Manufacturers to the terms of this STATE Fee Payment Agreement, and such other consideration described herein, the Original Participating Manufacturers and STATE Outside Counsel agree as follows:

Section 1. *Definitions.*

All definitions contained in the Agreement are incorporated by reference herein, except as to terms specifically defined herein.

(a) "*Action*" means the lawsuit identified in Exhibit D, M or N to the Agreement that has been brought by or against the State of STATE (or Litigating Political Subdivision).

(b) "*Allocated Amount*" means the amount of any Applicable Quarterly Payment allocated to any Private Counsel (including STATE Outside Counsel) pursuant to section 12 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 Liquidated Amount for any payment described therein, a percentage share of the Applicable Liquidated 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 Liquidated 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 videotape recordings of interviews).

(f) "*Approved Cost Statement*" means (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 13 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.

(bb) "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 to receive payments from the Original Participating Manufacturers [illegible] for the benefit of STATE Outside Counsel pursuant to sections 8, 16 and 18 hereof, as applicable.

(cc) "Director" means the Director of the Private Adjudication Center at 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 [illegible] of section 11 hereof.

(dd) "Eligible Counsel" means Private Counsel eligible to be allocated a part of a Quarterly Fee Amount pursuant to section 13 hereof.

(ee) "Federal Legislation" means federal legislation that imposes an enforceable obligation on Participating Defendants to pay attorneys' fees with respect to Private Counsel.

(ff) "Fee Award" means any award of attorneys' fees by the Panel in connection with a Tobacco Case.

(gg) "Liquidated Fee" means an amount of fees for Outside Counsel for any action identified on Exhibit [illegible] [illegible] to the extent that has been brought by or on behalf of a Settling State or Litigating Political Subdivision, in an amount agreed upon by the Original Participating Manufacturers and such Outside Counsel.

(hh) "Outside Counsel" means all Private Counsel identified on Exhibit S to the Agreement.

(ii) "Panel" means the three-member arbitration panel described in section 11 hereof.

(jj) "Party" means (i) STATE Outside Counsel and (ii) an Original Participating Manufacturer.

(kk) "Payable Cost Statement" means the unpaid amount of a Cost Statement as to which all conditions precedent to payment have been satisfied.

(ll) "Payable Liquidated Fee" means the unpaid amount of a Liquidated Fee as to which all conditions precedent to payment have been satisfied.

(mm) "Previously Settled States" means the States of Mississippi, Florida and Texas.

(nn) "Private Counsel" means all private counsel for all plaintiffs in a Tobacco Case (including STATE Outside Counsel).

(oo) "Quarterly Fee Amount" means, for purposes of the quarterly payments described in sections 16, 17 and 18 hereof:

(1) 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;

(2) 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 (i) $125 million and (ii) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year; [illegible]

(3) 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 (i) $125 million and (ii) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, [illegible] and (C) the difference, if any, between (i) $250 million and (ii) the product of [illegible] and [illegible] the sum of all amounts paid in satisfaction of all Liquidated Fees of Outside Counsel pursuant to section 8 hereof, if any;

(4) 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

(5) 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 (i) $375 million and (ii) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any.

(pp) "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).

(qq) "State of STATE" means the [illegible] Settling State, [illegible] and all of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and subdivisions.

(rr) "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.

(ss) "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 [illegible] actions) [illegible]

(tt) "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 [illegible] 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 parties represented by STATE Outside Counsel in the Action (except for 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 in 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 for 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 (b)(iii) 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 individual 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 [illegible] days after receipt of notice by the Designated Representative that STATE Outside

Counsel in excess of the 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 total 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 agency 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 18 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 10, 11 and 12 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 payment 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 became 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 annual caps on payment of 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 determination by such persons as may be authorized to make such selection 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 agreement entered in connection with the settlement 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, notwithstanding any limitations or representations made in any other agreement, the Original Participating Manufacturers shall be free to say or disclose anything whatsoever regarding the amount of the Fee Award requested by STATE Outside Counsel. The [illegible] the Panel [illegible] 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 15. *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 Appendix A hereto.

Section 16. *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 the STATE Outside Counsel or any Fee Award that already has been or 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 14 hereof. The Panel's decision as to the Fee Award of STATE Outside Counsel shall be final, binding and non-appealable.

Section 17. *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 18. *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 19. *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 (i), 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 19 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 prior calendar year affect the allocation of payments to be made in any subsequent calendar year.

Section 20. *Limitations on and Conditions to 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 nor considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

Section 21. *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 annual 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 seeks 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 case 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 examiners' audit report shall be submitted to the Director for submission 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 procedure [illegible] 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 such approval 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 Outside Counsel in connection with all of the actions identified in Exhibits D, M and N to the Agreement totaling more than $75 million during 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) of paragraph (c).

(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 encumbrance.

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 13 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, telecopy 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 STATE 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. The two party-appointed members of the Panel shall be governed by Canon VII of the *Code of Ethics*. No person may engage in 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. *Applications for Fee Awards and Other Submissions*

(a) The Application of STATE Outside Counsel and any related submissions 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 submissions 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 first-class mail, hand delivery or 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 and there must be an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Compensation*

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers in an amount to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all legal questions regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall advise the Parties of any communications to the arbitration proceedings to be received pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon III(B) of the *Code of Ethics*.

EXHIBIT P
WEBSITES

Intentionally Omitted

EXHIBIT D
1996 AND 1997 DATA

I. 1997 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	[illegible]
Lorillard Tobacco Co.	[illegible]
Philip Morris Inc.	[illegible]
R.J. Reynolds Tobacco Co.	[illegible]
Total (Base Operating Income)	[illegible]

II. 1997 Volume (as measured by [illegible] of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	[illegible]
Lorillard Tobacco Co.	[illegible]
Philip Morris Inc.	[illegible]
R.J. Reynolds Tobacco Co.	[illegible]
Total (Base Volume)	[illegible]

III. [illegible]

[illegible]	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	[illegible]
Lorillard Tobacco Co.	[illegible]
Philip Morris Inc.	[illegible]
R.J. Reynolds Tobacco Co.	[illegible]

* [illegible]

EXHIBIT E
EXCLUSIONS OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation
[illegible]
State Express 555
Raleigh

Philip Morris Incorporated
[illegible]

Lorillard Tobacco Company
None

R.J. Reynolds Tobacco Company
[illegible]

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section ___. Findings and Purpose.[1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On ________, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section ___. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette".

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on ________, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

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[1] [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation)--

1999: $.0094241 per unit sold after the date of enactment of this Act;[1]

2000: $.0104712 per unit sold after the date of enactment of this Act;[2]

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

[1] [Above amounts are subject to verification.]

[2] [The phrase "after the date of enactment of this Act" would need to be excluded only in the calendar year in which the Act is enacted.]

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.[3]

[3] [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 L

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 L.

Section 1

A panel comprised 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 L.

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.

CONSENT DECREE

At IAS Part 56 of the Supreme Court of the State of New York, held in and for the County of New York, at the Courthouse located at 60 Centre Street, New York, New York, on the 23rd day of December, 1998

PRESENT:

HON. STEPHEN G. CRANE, Justice

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE STATE OF NEW YORK and DENNIS C. VACCO, Attorney General of the State of New York, for and on behalf of the PEOPLE OF THE STATE OF NEW YORK,

Plaintiffs,

-against-

PHILIP MORRIS INCORPORATED; PHILIP MORRIS COMPANIES, INC.; RJR NABISCO, INC.; RJR NABISCO HOLDINGS CORP.; R.J. REYNOLDS TOBACCO CO.; THE AMERICAN TOBACCO CO., INC.; AMERICAN BRANDS, INC.; BROWN & WILLIAMSON TOBACCO CORP.; LORILLARD TOBACCO COMPANY; LORILLARD INCORPORATED, LOEWS CORPORATION; UNITED STATES TOBACCO COMPANY; UST, INC.; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; BATUS HOLDINGS, INC.; THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC., and TOBACCO INSTITUTE, INC.,

Defendants.

CONSENT DECREE AND FINAL JUDGMENT

Index No.: 400361/97
Hon. Stephen G. Crane, Justice

WHEREAS, Plaintiffs, the State of New York and Attorney General Dennis C. Vacco, commenced this action on January 27, 1997, pursuant to their common law powers and the provisions of N.Y. Executive Law, Public Health Law, General Business Law, Business Corporations Law, Penal Law, Social Services Law, Not-for-Profit Corporations Law, Unconsolidated Law, the Civil Practice Law and Rules, and the State Constitution;

WHEREAS, Plaintiffs asserted various claims for monetary, equitable and injunctive relief, on behalf of the State of New York, including its Counties under GBL §342-b, against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint and amended complaint and denied the State's allegations;

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this county.

II. DEFINITIONS

The definitions set forth in the Master Settlement Agreement ("MSA" or "Agreement") (a copy of which is attached hereto as Exhibit 1) are incorporated herein by reference. "County" means a county of the State of New York, including New York City with New York City to be treated as a single county and none of its constituent counties to be treated separately; "Counties" means the counties of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; provided, however, that any county that properly excludes itself from the class provisionally certified for settlement purposes only by this Court's Order of November 24, 1998 (the "Class") is not included in the definitions of "County" or "Counties."

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of New York or a Released Party. The State of New York may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment. Provided, however, that a County or Counties may enforce the payment rights provided in Article V of this Consent Decree and Final Judgment, but only against other Counties or the State. Only the State may enforce the provisions of Article V against the Participating Manufacturers.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. MONETARY RELIEF

A. Under subsections II(rr), (ss), IX, and XI of the MSA, payments from the Participating Manufacturers will be made to the Escrow Agent for further disbursement, pursuant to an Escrow Agreement executed by the parties and approved by a Court of competent jurisdiction. The State shall instruct the Independent Auditor and the Escrow Agent to disburse funds from the New York State-Specific Account directly to the State of New York and directly to the Counties individually according to the payment schedule annexed hereto as Exhibit 2.

B. The payment schedule set forth in Exhibit 2 shall remain in effect for as long as payments are made from the Participating Manufacturers under the MSA. The portion of those payments credited to the New York State-Specific Account, if any, shall be allocable to the State of New York and the individual Counties as set forth in Exhibit 2.

C. Effective upon the occurrence of State-Specific Finality in the State of New York, and to the extent that such claims may not otherwise be released by operation of the MSA, the Counties (as defined in this Consent Decree and Final Judgment) hereby absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Counties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall, or may have, to the same extent that the Settling States are releasing Released Claims against Released Parties under the MSA.

D. Each County (as defined in this Consent Decree and Final Judgment) further covenants and agrees that it shall not after the occurrence of State-Specific Finality in the State of New York sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

E. Upon the occurrence of State-Specific Finality in the State of New York, the City of New York (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of the action entitled *City of New York et al. v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of New York, Index No. 406225/96, and the County of Erie (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of its action entitled *County of Erie v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of Erie, Index No. 1997/359.

F. If a County or Counties properly excludes itself from the Class, such County or Counties shall not receive any funds under the MSA, and the State may, in its sole discretion, place the funds allocated to such County or Counties under Exhibit 2 to this Consent Decree And Final Judgment in escrow.

G. If any funds are recouped from the State of New York by the Federal Government, pursuant to an Act of Congress or otherwise, from monies received or to be received by the State (including its political subdivisions) from the New York State-Specific Account, then the State shall recoup from the Counties the Counties' share of such funds, through offsets or any other mechanisms selected by the State, according to the allocation percentages of the settlement funds in the year or years in question assigned to the respective Counties pursuant to the allocation schedule set forth in Exhibit 2. Nothing herein acknowledges a right of the Federal Government to recoup any such funds.

VI. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of New York in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of New York.

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of New York any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of New York any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of New York, any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of New York any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two for one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VII. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of New York and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of New York and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. A County may apply for further orders and directions as may be necessary or appropriate for the implementation or enforcement of the fourth sentence of Article III(B) of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections VI(A) and VI(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions; Provided, however, that the provisions of sections III, V, VI, VII and VIII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of New York and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of New York and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred by the State of New York in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of New York may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for New York to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of New York of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of New York or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection VI(A) or VI(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VIII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the persons signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of New York and the Counties.

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this 23rd day of December, 1998

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

/s/ SGC
J.S.C.

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

At all times and under all circumstances specified in Section XI of the Master Settlement Agreement that require the Independent Auditor to instruct the Escrow Agent to disburse amounts to the State of New York pursuant to the terms of the Master Settlement Agreement ("New York Disbursal Share"), the Independent Auditor shall allocate all such New York Disbursal Share among the State of New York, the City of New York[1], and the individual counties of New York according to the schedule set forth below and instruct the Escrow Agent to disburse such allocated amounts directly to the State of New York, the City of New York and the specified counties.

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Section IX(b) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows:

Entity	Percentage of Payment
New York State	51.176%
New York City	26.670%
Albany	0.593%
Allegheny	0.107%
Broome	0.446%
Cattaraugus	0.179%
Cayuga	0.166%
Chautauqua	0.308%
Chemung	0.212%
Chenango	0.104%
Clinton	0.170%
Columbia	0.126%
Cortland	0.100%
Delaware	0.101%
Dutchess	0.500%
Erie	2.194%
Essex	0.075%
Franklin	0.098%
Fulton	0.121%
Genessee	0.118%
Greene	0.085%
Hamilton	0.013%
Herkimer	0.142%
Jefferson	0.190%
Lewis	0.054%
Livingston	0.112%
Madison	0.131%
Monroe	1.536%
Montgomery	0.114%
Nassau	2.739%
Niagara	0.467%

[1]The City of New York includes the five individual boroughs of Manhattan, Bronx, Brooklyn, Queens and Staten Island, and the New York City Health and Hospitals Corporation.

Entity	Percentage of Payment
Oneida	0.544%
Onondaga	0.972%
Ontario	0.181%
Orange	0.564%
Orleans	0.076%
Oswego	0.239%
Otsego	0.122%
Putnam	0.152%
Rensselaer	0.317%
Rockland	0.560%
St. Lawrence	0.239%
Saratoga	0.304%
Schenectady	0.319%
Schoharie	0.063%
Schuyler	0.038%
Seneca	0.069%
Steuben	0.211%
Suffolk	2.673%
Sullivan	0.155%
Tioga	0.100%
Tompkins	0.170%
Ulster	0.334%
Warren	0.113%
Washington	0.113%
Wayne	0.172%
Westchester	1.926%
Wyoming	0.081%
Yates	0.044%

(2) With respect to amounts paid by the Participating Manufacturers pursuant to Section IX(c)(2) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse the entire proceeds to the State of New York.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. STEPHEN G. CRANE, *Justice* — Part 56

THE STATE OF NEW YORK, et al., *Plaintiff,* v. PHILIP MORRIS, INC., et al., *Defendants.*	INDEX NO.: 400361/97 MOTION DATE: 4/13/99 MOTION SEQ. NO.: 019 MOTION CAL. NO.: 139

The following papers, numbered 1 to __ were read on this motion to/for ________

	PAPERS NUMBERED
Notice of Motion/Order to Show Cause — Affidavits — Exhibits	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: [ ] Yes [X] No

The State of New York and defendants Brown & Williamson Tobacco Corporation, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company, jointly move for an order, pursuant to CPLR 5019(a), correcting Exhibit 2 to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, so that the "Consent Decree and Final Judgment" accurately reflects the original intention of the parties and the terms of the Master Settlement Agreement with respect to the intra-State allocation of annual payments by the Participating Manufacturers pursuant to Section IX(c)(1) of the Master Settlement Agreement. The motion is granted on default.

Accordingly, it is

ORDERED that the motion is granted on default; and it is further

ORDERED that Paragraph (1) of "Exhibit 2" to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, shall be amended to read as follows:

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Sections IX(b) or IX(c)(1) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows . . . .

The foregoing constitutes the decision and order of the court.

Dated: April 14, 1999

/s/ SGC
STEPHEN G. CRANE J.S.C.

Check One: [ ] FINAL DISPOSITION [X] NON-FINAL DISPOSITION
/s/ MDAR

FINANCIAL STATEMENTS AND REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

TSASC, INC.

June 30, 2001 and 2000

CONTENTS

Grant Thornton

Accountants and Management Consultants

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors of
TSASC, Inc.

We have audited the accompanying basic financial statements of TSASC, Inc. ("TSASC") as of June 30, 2001 and 2000, and for the year ended June 30, 2001 and for the period from November 1, 1999 (inception) to June 30, 2000. These basic financial statements are the responsibility of TSASC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of TSASC, Inc. as of June 30, 2001 and 2000, and the results of its activities and operations for the year ended June 30, 2001 and for the period from November 1, 1999 (inception) to June 30, 2000 in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying management's discussion and analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

As described in Note B, TSASC adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as of July 1, 2000. In addition, as described in Note B, TSASC adopted the provisions of Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* as of July 1, 2000. The accompanying basic financial statements for the period from November 1, 1999 (inception) to June 30, 2000 have been restated to reflect the changes required by these statements.

Grant Thornton LLP

New York, New York
September 7, 2001

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TSASC, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview of the Financial Statements

The following is a narrative overview and analysis of the financial performance of TSASC, Inc.'s ("TSASC") financial activities for the fiscal year ended June 30, 2001. Please read it in conjunction with TSASC's entity-wide financial statements, governmental fund financial statements and the notes to the financial statements.

The annual financial statements consist of three parts: (1) management's discussion and analysis (this section), (2) the entity-wide financial statements and (3) the governmental fund financial statements.

The entity-wide financial statements of TSASC, which include the statement of net assets (deficit) and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with GASB No. 34. The statement of net assets (deficit) and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting. All revenues and expenses are taken into account regardless of when cash is paid or received. This is to provide the reader with a broad overview of TSASC's finances, similar to private-sector financial statements.

TSASC's governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. They recognize revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period.

The reconciliations of the statement of revenues, expenditures and changes in fund balances of governmental funds to the statement of activities are presented to assist the reader in understanding the differences between entity-wide and governmental fund financial statements.

Financial Highlights and Overall Analysis - Entity-Wide Financial Statements

Total assets increased by $7 million (3.5%), which is basically due to a higher tobacco settlement revenue receivable at June 30, 2001. Total liabilities decreased by $4 million (5%), basically due to a principal payment of $5.6 million in the fiscal year 2001.

Tobacco settlement revenues ("TSRs") decreased by $141 million (40%) in the fiscal year ended June 30, 2001. The decrease is attributed to the prior period, which was the initial year of operations. TSRs in the prior period included (1) a single upfront payment from the tobacco companies of $84 million and (2) the inclusion of TSRs for cigarette sales from January 1, 1999 through June 30, 2000 (18 months).

Total program expenses decreased by $588 million (93%). This decrease in program expenses is from the decrease of $604 million (100%) in distributions to New York City for the capital program (bonds were not issued in the fiscal year ended June 30, 2001, thus no distribution) and an increase of $16 million in bond interest expense, which is due to a full year of interest in the year ended June 30, 2001.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Financial Highlights and Overall Analysis - Governmental Financial Statements

Total assets and total liabilities increased by $8 million, which is due to the $8 million increase in TSRs receivable at June 30, 2001 and the corresponding increase in deferred revenue of $8 million.

Gross TSRs decreased by $71 million mainly due to the single upfront payment from the tobacco companies of $84 million received in the prior period. TSRs retained increased by $22 million, which was required for increased debt service in the fiscal year ended June 30, 2001.

Total expenditures decreased by $563 million. The decrease consists of (1) a decrease of $604 million (100%) in distributions to New York City for the capital program (bonds were not issued in the fiscal year ended June 30, 2001, and thus there was no distribution), (2) a $15 million decrease in cost of bonds issued in 2001, (3) $50 million increase in bond interest expense (first year of payment was 2001) and (4) a principal payment of $5.6 million in the fiscal year 2001.

TSASC, Inc.

STATEMENTS OF NET ASSETS (DEFICIT)

June 30,
(in thousands)

	2001	2000
ASSETS		
Restricted cash and cash equivalents	$ 60,272	$ 218
Restricted investments	53,226	113,397
Tobacco settlement revenue receivable	86,800	78,800
Bond issue cost	13,486	14,202
Total assets	213,784	206,617
LIABILITIES		
Accrued expenses	-	35
Accrued interest payable	19,825	26,940
Remittances payable to the Trust	86,800	78,800
Bonds payable		
Portion due within one year	9,430	5,620
Portion due after one year	694,230	703,660
Unamortized bond discount	(7,468)	(7,865)
Total liabilities	802,817	807,190
NET ASSETS (DEFICIT)		
Restricted for capital program	812	167
Restricted for debt service	112,686	113,413
Deficit	(702,531)	(714,153)
Total net assets (deficit)	$(589,033)	$(600,573)

The accompanying notes are an integral part of these statements.

TSASC, Inc.

STATEMENTS OF ACTIVITIES

(in thousands)

	Year ended June 30, 2001	Period from November 1, 1999 (inception) to to June 30, 2000
Expenses		
General and administrative expenses	$ 381	$ 257
Distributions to New York City for capital program	-	603,818
Bond interest expense	43,509	27,340
Bond issue expense	716	723
Total program expenses	44,606	632,138
General revenues		
Tobacco settlement revenue	212,328	353,723
Less remittances to the Trust	(162,340)	(326,164)
Net tobacco settlement revenues	49,988	27,559
Investment earnings	6,158	4,006
Total general revenues	56,146	31,565
Change in net assets	11,540	(600,573)
Net assets (deficit) - beginning of period	(600,573)	-
Net assets (deficit) - end of period	$(589,033)	$(600,573)

The accompanying notes are an integral part of these statements.

TSASC, Inc.

BALANCE SHEET

Governmental Funds

June 30, 2001
(in thousands)

	Capital Projects	Debt Service	Total Governmental Funds
ASSETS			
Restricted cash and cash equivalents	$812	$ 59,460	$ 60,272
Restricted investments	-	53,226	53,226
Tobacco settlement revenue receivable	-	86,800	86,800
Total assets	$812	$199,486	$200,298
LIABILITIES AND FUND BALANCES			
Liabilities			
Deferred tobacco settlement revenue	$ -	$ 86,800	$ 86,800
Total liabilities	-	86,800	86,800
Fund balances			
Reserved for capital program	812	-	812
Reserved for debt service	-	112,686	112,686
Total fund balances	812	112,686	113,498
Total liabilities and fund balances	$812	$199,486	$200,298

The accompanying notes are an integral part of this statement.

TSASC, Inc.

BALANCE SHEET

Governmental Funds

June 30, 2000
(in thousands)

	Capital Projects	Debt Service	Total Governmental Funds
ASSETS			
Restricted cash and cash equivalents	$202	$ 16	$ 218
Restricted investments	-	113,397	113,397
Tobacco settlement revenue receivable	-	78,800	78,800
Total assets	$202	$192,213	$192,415
LIABILITIES AND FUND BALANCES			
Liabilities			
Accrued expenses	$ 35	$ -	$ 35
Deferred tobacco settlement revenue	-	78,800	78,800
Total liabilities	35	78,800	78,835
Fund balances			
Reserved for capital program	167	-	167
Reserved for debt service	-	113,413	113,413
Total fund balances	167	113,413	113,580
Total liabilities and fund balances	$202	$192,213	$192,415

The accompanying notes are an integral part of this statement.

TSASC, Inc.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

Governmental Funds

Year ended June 20, 2001
(in thousands)

	Capital Projects	Debt Service	Total Governmental Funds
Revenues			
Tobacco settlement revenue	$ -	$ 204,328	$ 204,328
Less remittances to the Trust	-	(154,340)	(154,340)
Tobacco settlement revenues retained	-	49,988	49,988
Interest income	26	6,132	6,158
Total revenues	26	56,120	56,146
Expenditures			
Bond interest expense	-	50,227	50,227
Principal amount of bonds retired	-	5,620	5,620
General and administrative expenses	381	-	381
Total expenditures	381	55,847	56,228
Excess (deficiency) of revenues over expenditures	(355)	273	(82)
Other financing sources (uses)			
Transfers in (out)	1,000	(1,000)	-
Total other financing sources and uses	1,000	(1,000)	-
Net change in fund balances	645	(727)	(82)
Fund balances - beginning of period	167	113,413	113,580
Fund balances - end of period	$ 812	$ 112,686	$ 113,498

The accompanying notes are an integral part of this statement.

TSASC, Inc.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

Governmental Funds

November 1, 1999 (inception) to June 30, 2000
(in thousands)

	Capital Projects	Debt Service	Total Governmental Funds
Revenues			
Tobacco settlement revenue	$ -	$ 274,923	$ 274,923
Less remittances to the Trust	-	(247,364)	(247,364)
Tobacco settlement revenues retained	-	27,559	27,559
Interest income	11	3,995	4,006
Total revenues	11	31,554	31,565
Expenditures			
Costs of bond issuance	14,925	-	14,925
Distributions to New York City for capital program	603,818	-	603,818
General and administrative expenses	257	-	257
Total expenditures	619,000	-	619,000
Excess (deficiency) of revenues over expenditures	(618,989)	31,554	(587,435)
Other financing sources (uses)			
Principal amount of bonds issued	709,280	-	709,280
Bond discount	(8,265)	-	(8,265)
Transfers in (out)	(81,859)	81,859	-
Total other financing sources and uses	619,156	81,859	701,015
Net change in fund balances	167	113,413	113,580
Fund balances - beginning of period	-	-	-
Fund balances - end of period	$ 167	$ 113,413	$ 113,580

The accompanying notes are an integral part of this statement.

TSASC, Inc.

RECONCILIATIONS OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

(in thousands)

	Year ended June 30, 2001	Period from November 1, 1999 (inception) to to June 30, 2000
Net change in fund balances - total governmental funds	$ (82)	$ 113,580
Amounts reported for governmental activities in the statement of activities are different because:		
Bond proceeds provide current financial resources to governmental funds, but debt issued increases long-term liabilities in the statement of net assets.	-	(709,280)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	5,620	-
Governmental funds report costs of debt issuance as expenditures. However, in the statement of activities, the cost of debt issuance is amortized over the lives of the debt.	(716)	14,202
Governmental funds report bond discounts as other financing uses. However, in the statement of activities, bond discounts are amortized over the lives of the debt as interest expense.	(397)	7,865
Interest expense is reported in the statement of activities on the accrual basis, but interest is reported as expenditure in governmental funds when outlay of financing resources is required.	7,115	(26,940)
Change in net assets of governmental activities	$11,540	$(600,573)

The accompanying notes are an integral part of these statements.

TSASC, Inc.

NOTES TO FINANCIAL STATEMENTS

June 30, 2001 and 2000

NOTE A - ORGANIZATION

TSASC, Inc. ("TSASC") is a special purpose, local development corporation organized under the Not-For-Profit Corporation Law of the State of New York (the "State"). TSASC is an instrumentality of, but separate and apart from, the City of New York (the "City"). TSASC is governed by a Board of five directors, consisting of the following officials of the City: the Director of Management and Budget (who also serves as Chairperson), the Commissioner of Finance, the Corporation Counsel of the City, the Comptroller and the Speaker of the Council. Although legally separate from the City, TSASC is a component unit of the City and, accordingly, is included in the City's financial statements.

Pursuant to a Purchase and Sale Agreement with the City, the City sold to TSASC all of its future right, title and interest in the Tobacco Settlement Revenues ("TSRs") under the Master Settlement Agreement ("MSA") and the Decree and Final Judgment (the "Decree"). The MSA resolved cigarette smoking-related litigation between the settling states and the Participating Manufacturers ("PMs"), released the PMs from past and present smoking-related claims, and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the settling states, as well as certain tobacco advertising and marketing restrictions, among other things. The Decree, which was entered by the Supreme Court of the State, allocated to the City a share of the TSRs under the MSA. The future rights, title and interest of the City's share were sold to TSASC.

The purchase price of the City's future right, title and interest in the TSRs has been financed by the issuance of a series of bonds and the Residual Certificate. The Residual Certificate represents the entitlement to receive all amounts required to be distributed after payment of debt service, operating expenses and certain other costs as set forth in the indenture. Payments on the Residual Certificate from TSR collections are subordinate to payments on the bonds and payment of certain other costs specified in the indenture. Excess TSRs not required by TSASC to pay various expenses, debt service or required reserves with respect to the bonds are transferred to the TSASC Tobacco Settlement Trust (the "Trust"), as owner of the Residual Certificate. The City is the beneficial owner of the Trust and thus the funds received by the Trust are transferred to the City.

TSASC is expecting to issue a total amount of Tobacco Flexible Amortization Bonds in the approximate principal amount of $2.8 billion, which includes the $709 million issued as of June 30, 2001.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

During the year ended June 30, 2001, TSASC elected to adopt the provisions of Statement No. 34 of the Governmental Accounting Standards Board ("GASB No. 34"), *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* accordingly, the accompanying financial statements for the period from November 1, 1999 (inception) to June 30, 2000 have been restated to conform with GASB No. 34 requirements.

The entity-wide financial statements of TSASC, which include the statement of net assets (deficit) and the statement of activities, are presented to display information about the reporting entity as a whole, in accordance with Statement No. 34 of the Governmental Accounting Standards Board. The statement of net assets (deficit) and the statement of activities are prepared using the economic resources measurement focus and the accrual basis of accounting.

In addition, TSASC adopted the provisions of Statement No. 33 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Nonexchange Transactions* ("GASB No. 33"). The accompanying financial statements for the period from November 1, 1999 (inception) to June 30, 2000 have been restated to reflect the changes required by this statement. The implementation of GASB No. 33 resulted in an increase to tobacco settlement revenue receivable and related deferred tobacco settlement revenue in TSASC's Debt Service Fund of approximately $87 million and $79 million for the year ended June 30, 2001 and the period from November 1, 1999 (inception) to June 30, 2000, respectively.

TSASC's governmental fund financial statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting. They recognize revenue when it becomes susceptible to accrual, which is when it becomes both measurable and available to finance expenditures in the current fiscal period. Expenditures are recognized when the related liability is incurred, except for unmatured interest on bonds payable, which is recognized when due. The governmental funds consist of the Capital Projects Fund, which accounts for resources to be transferred to the City's capital program and supports the operations of TSASC, and the Debt Service Fund which accounts for the accumulation of resources for payment of principal and interest on long-term debt.

Investments, including accrued interest, are reported at fair value.

Bond premiums, discounts and issuance costs are capitalized and amortized over the lives of the related debt using the interest method in the entity-wide financial statements. The governmental fund financial statements recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources while discounts on debt issuances are reported as other financing uses.

NOTE B (continued)

Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Interest expense is recognized on the accrual basis in the entity-wide financial statements. Interest expenditures are recognized when paid in the individual governmental fund financial statements.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires TSASC's management to make estimates and assumptions in determining the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE C - BONDS PAYABLE

In connection with the purchase of the City's future right, title and interest in the TSRs, TSASC expects to issue obligations in an aggregate principal amount of $2.8 billion, of which TSASC has issued $709 million at June 30, 2001. TSASC has pledged all of its tangible and intangible assets, including the TSRs, all investment earnings on amounts on deposit, and amounts on deposit in all reserve accounts established under the indenture, as collateral to secure its bonds. TSASC retains TSRs in an amount sufficient to service its debt, not otherwise provided for from bond proceeds, and pay its operating expenses, and remits the remaining balance to the Trust.

Outstanding bonds payable bear interest at rates ranging from 4.0% to 6.375%. A summary of changes in outstanding bonds during the last two fiscal years is as follows (in thousands):

Balance at November 1, 1999 (inception)	$ -
Bonds issued - fiscal year 2000	709,280
Balance at June 30, 2000	709,280
Principal amount retired - fiscal year 2001	(5,620)
Balance at June 30, 2001	$703,660

NOTE C (continued)

Debt service requirements for rated maturities and planned principal payments, including principal and interest, at June 30, 2001, are as follows (in thousands):

	Rated Maturities			Planned Principal Payments		
	Principal	Interest	Total	Principal	Interest	Total
Year ended June 30,						
2002	$ -	$ 43,458	$ 43,458	$ 9,430	$ 43,020	$ 52,450
2003	-	43,458	43,458	8,915	42,590	51,505
2004	3,015	43,278	46,293	8,515	42,161	50,676
2005	2,875	43,033	45,908	6,520	41,780	48,300
2006	3,485	42,888	46,373	7,345	41,419	48,764
2007 to 2011	28,675	210,973	239,648	52,110	199,668	251,778
2012 to 2016	43,330	200,928	244,258	81,775	179,958	261,733
2017 to 2021	66,830	186,453	253,283	143,065	146,987	290,052
2022 to 2026	105,885	159,158	265,043	204,730	91,154	295,884
2027 to 2031	129,615	121,997	251,612	181,255	22,907	204,162
2032 to 2036	165,870	76,803	242,673	-	-	-
2037 to 2040	154,080	19,234	173,314	-	-	-
	$ 703,660	$1,191,661	$1,895,321	$703,660	$851,644	$1,555,304

Rated maturities for these bonds represent the minimum amount of principal that TSASC must pay as of the specific distribution dates in order to avoid a default. The planned principal payments represent the amount of principal that TSASC has covenanted to pay to the extent of available TSRs collected.

At June 30, 2001 and 2000, TSASC maintained its required debt service accounts totaling $112,686,000 and $113,413,000, respectively, which includes $9,430,000 and $5,620,000, respectively, for principal retirement, $43,020,000 and $50,226,000, respectively, for interest payments, $54,553,000 and $53,669,000, respectively, for liquidity reserves, and $5,683,000 and $3,898,000, respectively, of interest earnings.

NOTE D - CASH AND CASH EQUIVALENTS

TSASC's cash and cash equivalents consist of bank deposits and short-term U.S. Government guaranteed securities with original maturities of three months or less. At June 30, 2001 and 2000, total cash and cash equivalents of $60,272,000 and $218,000, respectively, consist primarily of short-term U.S. Government guaranteed securities held by TSASC's agent in TSASC's name.

NOTE E - INVESTMENTS

At June 30, 2001 and 2000, investments totaling $53,226,000 and $113,397,000, respectively, consist of U.S. Government-guaranteed securities held by TSASC's agent in TSASC's name.

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August 15, 2002

TSASC, INC.

We have acted as transaction counsel to TSASC, INC. (the "Corporation"), a corporation organized under the laws of the State of New York (the "State"), in the Corporation's issuance of its Tobacco Settlement Asset-Backed Bonds, Series 2002-1 (the "Bonds"). The Bonds are being issued as Senior Bonds pursuant to an Indenture dated as of November 1, 1999, as supplemented (the "Indenture"), between the Corporation and The Bank of New York, as successor in interest to United States Trust Company of New York, as Trustee.

The Bonds are dated, bear interest, mature, are subject to redemption and are secured as set forth in the Indenture. The Corporation is authorized to issue additional Senior Bonds (together with the Bonds and outstanding bonds on a parity therewith, the "Senior Bonds") only on the terms and conditions set forth in the Indenture and all such Senior Bonds shall be entitled to the equal benefit, protection and security of the Indenture. We assume the parties will perform in all material respects their respective covenants in the Indenture and the Purchase and Sale Agreement dated November 18, 1999, as amended (the "Agreement"), between the Corporation and The City of New York (the "City").

Based on the foregoing and our examination of existing constitutional, statutory and decisional law, and such legal proceedings and such other documents as we deem necessary to render this opinion, we are of the opinion that:

1. The Corporation is duly organized and existing under the laws of the State, and is authorized under the laws of the State to enter into the Indenture and the Agreement and to issue the Bonds.

2. The Indenture (a) has been duly and lawfully authorized, executed and delivered by the Corporation, (b) creates the valid pledge of and security interest in the revenues and other collateral (collectively, the "Trust Estate") that it purports to create and (c) is a valid and binding agreement of the Corporation, enforceable in accordance with its terms. All action has been taken as is necessary to perfect such pledge and security interest in the Trust Estate as it exists on the date hereof and such perfected pledge and security interest constitutes a first priority pledge and security interest.

3. The Bonds have been duly authorized, executed, and delivered by the Corporation and are valid and binding obligations of the Corporation payable from the sources and in the order of priority specified in the Indenture. The Bonds do not constitute a debt of the State or the City, and neither the State nor the City shall be liable thereon, nor shall the Bonds be payable out of any funds other than those of the Corporation.

4. The Agreement has been duly and lawfully authorized, executed and delivered by the Corporation and the City and is a valid and binding agreement of each of them, enforceable in accordance with its terms.

5. Except as provided in the following sentence, interest on the Bonds is not includable in the gross income of the owners of the Bonds for purposes of Federal, New York State or New York City income taxation under existing law. Interest on the Bonds will be includable in the gross income of the owners thereof retroactive to the date of issue of the Bonds in the event of a failure by the Corporation or the City to comply with the applicable requirements of the Internal Revenue Code of 1986, as amended (the "Tax Code"), and their respective covenants regarding use, expenditure and investment of bond proceeds and the timely payment of certain investment earnings to the United States Treasury; and we render no opinion as to the exclusion from gross income of interest on the Bonds for Federal income tax purposes on or after the date on which any action is taken under the Indenture or related proceedings upon the approval of counsel other than ourselves.

6. Interest on the Bonds is not a specific preference item for purposes of the Federal individual or corporate alternative minimum tax. The Tax Code contains other provisions that could result in tax consequences, upon which we render no opinion, as a result of ownership of such Bonds or the inclusion in certain computations (including without limitation those related to the corporate alternative minimum tax) of interest that is excluded from gross income.

7. The excess, if any, of the amount payable at maturity of any maturity of the Bonds purchased as part of the initial public offering over the issue price thereof constitutes original issue discount. The amount of original issue discount that has accrued and is properly allocable to an owner of any maturity of the Bonds with original issue discount is excluded from gross income for Federal, State and City income tax purposes to the same extent as interest on the Bonds. In general, the issue price of a maturity of the Bonds is the first price at which a substantial amount of Bonds of that maturity was sold (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers). The Tax Code further provides that such original issue discount excluded as interest accrues in accordance with a constant yield method based on the compounding of interest, and that a holder's adjusted basis for purposes of determining a holder's gain or

loss on disposition of the Bonds with original issue discount will be increased by the amount of such accrued interest.

The rights of the holders of the Bonds and the enforceability thereof and of the Agreement may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted, and to general principles of equity.

Our opinion in paragraph 2 is subject to the following assumptions, limitations, qualifications and exceptions:

a. We have assumed that there are no claims or liens on the Trust Estate in favor of any governmental entity or any agency or instrumentality thereof (including federal tax liens and liens arising under Title IV of the Employee Retirement Income Security Act of 1974, as amended);

b. We call to your attention that Section 552 of the Bankruptcy Code limits the extent to which property acquired by a debtor after the commencement of a case under the Bankruptcy Code may be subject to a security interest arising from a security agreement entered into by the debtor before the commencement of such case; and

c. We call to your attention that the security interests of the Trustee in collateral consisting of proceeds is limited to the extent set forth in Section 9-306 in the Uniform Commercial Code of the State.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions. Such opinions may be adversely affected by actions taken or events occurring, including a change in law, regulation or ruling (or in the application or official interpretation of any law, regulation or ruling) after the date hereof. We have not undertaken to determine, or to inform any person, whether such actions are taken or such events occur and we have no obligation to update this opinion in light of such actions or events.

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TSASC

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