Ratings: S&P: Uninsured AA-/Insured AAA
Fitch: Uninsured A+/Insured AAA
(See "Ratings" herein)

NEW ISSUE **BOOK-ENTRY ONLY**

*In the opinion of Hawkins, Delafield & Wood, Bond Counsel, under existing statutes and court decisions, assuming continuing compliance with certain tax covenants as described herein, interest on the Series 2003B Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "**Code**"). In addition, interest on the Series 2003B Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code. Such interest, however, is included in the adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations. In addition, in the opinion of Bond Counsel, under the Act, interest on the Series 2003B Bonds is exempt from personal income taxes imposed by the State of New York and its political subdivisions, including The City of New York. See "TAX MATTERS" herein regarding certain other tax considerations.*

$2,240,415,000
Tobacco Settlement Financing Corporation (State of New York)
Asset-Backed Revenue Bonds, Series 2003B (State Contingency Contract Secured)
Consisting of

$2,015,415,000
Asset-Backed Revenue Bonds,
Series 2003B-1 and Series 2003B-1C
(State Contingency Contract Secured) (Fixed Rate)

$225,000,000
Asset-Backed Revenue Bonds,
Series 2003B-2 through 2003B-5
(State Contingency Contract Secured) (Auction Rate)

Dated: Date of Delivery **Due: June 1, as shown on pages (i) and (ii)**

Payment and Security: The Asset-Backed Revenue Bonds, Series 2003B (the "**Series 2003B Bonds**") are special obligations of the Tobacco Settlement Financing Corporation (the "**Corporation**"), issued under the Indenture, dated as of December 1, 2003, as supplemented by the Series 2003B Supplement and including schedules thereto (collectively, the "**Indenture**"), between the Corporation and The Bank of New York, as indenture trustee (the "**Trustee**"). The Series 2003B Bonds are payable from and secured by a pledge of the "**Pledged Revenues,**" which consist primarily of (i) the Pledged Settlement Payments sold by the State of New York (the "**State**") to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Sale Agreement**"), between the State and the Corporation and (ii) the payments (the "**Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Contract**"), between the State and the Corporation, in such amounts, subject to appropriation by the State Legislature, as are necessary to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Pledged Revenues Account, the Debt Service Account, the Supplemental Account and the Debt Service Reserve Account (collectively, the "**Pledged Accounts**") are insufficient therefor.

Pursuant to the Act and the Sale Agreement, the State will sell to the Corporation, on the Closing Date, the "**Pledged Settlement Payments,**" consisting of (i) fifty percent (50%) of the annual payments and strategic contribution payments (as defined herein) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received on and after January 1, 2004 and (ii) fifty percent (50%) of all Lump Sum Payments (as defined herein) received at any time on or after the date of delivery of the Series 2003B Bonds (the "**Closing Date**"), less, with respect to either (i) or (ii) above, the "**Unsold Settlement Payments**", which consist of, whenever received by the State, (i) payment of funds to the State to resolve claims relating to amounts held as of June 19, 2003 in the disputed payments account as defined in the escrow agreement under the MSA, and (ii) fifty percent (50%) of the annual payments, and of all adjustments to prior payments, owed to the State on and after January 1, 2004 and prior to January 1, 2005, and of all Lump Sum Payments received at any time on and after the Closing Date and prior to January 1, 2005, but only to the extent the amount described in this clause (ii) represents the excess of such payments over the first $22,951,241 received. Such $22,951,241 constitutes Pledged Settlement Payments. The Master Settlement Agreement (the "**MSA**") was entered into by participating cigarette manufacturers (the "**PMs**"), the State, 45 other states and six other U.S. jurisdictions (collectively, the "**Settling States**"), in November 1998 in the settlement of certain smoking-related litigation pursuant to which the PMs agreed to make certain payments to the Settling States (such payments as more fully described herein, the "**Tobacco Settlement Revenues**"). The State has previously sold certain Tobacco Settlement Revenues (the "**Previously Purchased and Pledged Settlement Payments**") to the Corporation and the Corporation has assigned such Previously Purchased and Pledged Settlement Payments to a trustee ("**Series 2003A Trustee**") under a separate indenture in connection with the issuance by the Corporation of its Asset-Backed Revenue Bonds, Series 2003A (State Contingency Contract Secured) (the "**Series 2003A Bonds**"). The Series 2003A Bonds are separately secured by the Previously Purchased and Pledged Settlement Payments and a Contingency Contract relating thereto. No portion of the Pledged Settlement Payments or the Pledged Accounts will be available to holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments. Neither the Corporation nor the Trustee (or any future assignee or successor of the Trustee) shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to mitigate all or any part of an asserted deficiency in the Previously Purchased and Pledged Settlement Payments or the Unsold Settlement Payments from the Pledged Settlement Payments. The right of the Trustee (or any future assignee or successor of the Trustee) to receive Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to, the right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments.

The proceeds of the Series 2003B Bonds, except as deposited in the Debt Service Reserve Account and the Debt Service Account, and other assets of the Corporation (other than the Pledged Revenues) are not pledged to the payment of, and are therefore not available to the holders of, the Series 2003B Bonds. Pursuant to the Act and the Sale Agreement, the State has covenanted for the benefit of the Bondholders that it will not in any way impair the rights and remedies of the Bondholders or the security for the Bonds.

PURSUANT TO THE ACT, THE SERIES 2003B BONDS SHALL NOT CONSTITUTE A DEBT OR MORAL OBLIGATION OF THE STATE OR A STATE SUPPORTED OBLIGATION WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY PROVISION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF THE TAXING POWER OF THE STATE, AND THE STATE SHALL NOT BE LIABLE TO MAKE ANY PAYMENTS THEREON NOR SHALL ANY SERIES 2003B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER.

Description: The Series 2003B Bonds will be dated their date of delivery and mature on the dates and in the aggregate principal amounts set forth on the pages (i) and (ii). Interest on the Series 2003B Bonds, including the Auction Rate Bonds, will be payable on June 1 and December 1 of each year, commencing on June 1, 2004. The interest on the Series 2003B Bonds payable on June 1, 2004 and a portion of the interest on the Series 2003B Bonds payable on December 1, 2004 will be paid from capitalized interest. For a description of the method of determination of interest rates, interest periods and certain other terms applicable to the Auction Rate Bonds, see pages (i) and (ii). **This Official Statement, in general, describes the Auction Rate Bonds only during the Auction Rate Mode.**

Redemption and Purchase: *The Series 2003B Bonds are subject to redemption and purchase prior to maturity as described herein. See "THE SERIES 2003B BONDS."*

See Pages (i) and (ii) for Maturity Schedule, Interest Rates, and Prices or Yields

Payment of the principal and Sinking Fund Installements of and interest on the Series 2003B-2 Bonds, the Series 2003B-3 Bonds and the Series 2003B-4 Bonds when due will be insured by a financial guaranty insurance policy issued by XL Capital Assurance Inc. ("**XL Capital**") simultaneously with the delivery of the Series 2003B Bonds.

Payment of the principal of and interest on the Series 2003B-5 Bonds when due will be insured by a financial guaranty insurance policy issued by CDC IXIS Financial Guaranty North America, Inc. (of "**CIFG NA**" and, together with XL Capital, the "**Insurers**") simultaneously with the delivery of the Series 2003B Bonds.

Fixed Rate Underwriters

JPMorgan†
Bear, Stearns & Co. Inc.† **Citigroup**† **Lehman Brothers** **Merrill Lynch & Co.**
Morgan Stanley **Ramirez & Co., Inc.** **Raymond James & Associates, Inc.**
Advest, Inc./Lebenthal & Co. **Banc of America Securities LLC** **BNY Capital Markets, Inc.**
CIBC World Markets **GMAC Commercial Holding Capital Markets** **Goldman, Sachs & Co.**
Janney Montgomery Scott LLC **M◆R◆ Beal & Company** **Prager & Sealy LLC** **RBC Dain Rauscher Inc.**
Roosevelt & Cross, Inc. **Wachovia Bank, National Association**
UBS Financial Services Inc.†

The Series 2003B Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Hawkins, Delafield & Wood, New York, New York, as Bond Counsel to the Corporation. Certain legal matters will be passed upon for the Corporation by its Counsel. Certain legal matters will be passed upon by Nixon Peabody LLP, New York, New York, as Disclosure Counsel to the Corporation and for the Underwriters by Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., New York, New York, as Underwriters' Counsel. Certain legal matters will be passed upon for the State by the Attorney General. It is expected that the Series 2003B Bonds will be available for delivery in book-entry form only through The Depository Trust Company in New York, New York on or about December 2, 2003.

November 20, 2003

† Acting also as the sole underwriter of certain Auction Rate Bonds.

$2,240,415,000
Tobacco Settlement Financing Corporation (State of New York)
Asset-Backed Revenue Bonds (State Contingency Contract Secured), Series 2003B

$302,180,000
Series 2003B-1 Bonds*

Serial Maturity Date (June 1)	Principal Amount	Interest Rate	Yield	CUSIP†
2005	$ 9,445,000	4%	1.68%	88880TFG6
2005	30,805,000	5	1.68	88880TFH4
2006	44,825,000	5	2.15	88880TFJ0
2007	39,915,000	4	2.57	88880TFK7
2007	9,525,000	5	2.57	88880TFL5
2008	73,870,000	5	2.95	88880TFM3
2009	11,955,000	3⅛	3.21	88880TFN1
2009	13,045,000	5	3.21	88880TFP6
2010	25,000,000	5	3½	88880TFQ4
2011	22,270,000	5	3.77	88880TFR2
2012	21,525,000	4	4.01	88880TFS0

* Not subject to optional redemption prior to maturity.

$1,713,235,000
Series 2003B-1C Bonds**

Serial Maturity Date (June 1)	Principal Amount	Interest Rate	Yield	CUSIP†
2009	$ 55,515,000	5½%	1.90%	88880TFT8
2010	62,205,000	5½	2¼	88880TFU5
2011	72,165,000	5%	3.43	88880TFV3
2012	80,340,000	5¼	3¾	88880TFW1
2013	109,680,000	5¼	3.96	88880TFX9
2014	5,115,000	4	4.09	88880TFY7
2014	112,995,000	5½	4.09	88880TFZ4
2015	127,100,000	5½	4.27	88880TGA8
2016	137,030,000	5½	4.40	88880TGB6
2017	6,285,000	4⅜	4.49	88880TGC4
2017	141,190,000	5½	4.49	88880TGD2
2018	161,990,000	5½	4.59	88880TGE0
2019	173,860,000	5½	4.67	88880TGF7
2020	8,885,000	4.7	4.72	88880TGG5
2020	177,415,000	5½	4.72	88880TGH3
2021	199,690,000	5½	4.77	88880TGJ9
2022	81,775,000	5½	4.80	88880TGK6

** Subject to optional redemption prior to maturity. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS—Redemption and Purchase Provisions".

$225,000,000
Series 2003B-2 Bonds through Series 2003B-5 Bonds

$40,000,000 Series 2003B-2 Auction Rate Bond† Due June 1, 2022; Price of 100%, CUSIP*: 88880TFC5
$40,000,000 Series 2003B-3 Auction Rate Bond† Due June 1, 2022; Price of 100%, CUSIP*: 88880TFD3
$70,000,000 Series 2003B-4 Auction Rate Bond† Due June 1, 2023††; Price of 100%, CUSIP*: 88880TFE1
$75,000,000 Series 2003B-5 Auction Rate Bond††† Due June 1, 2023; Price of 100%, CUSIP*: 88880TFF8

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† Insured by XL Capital.
†† Sinking Fund Installment of $50,775,000 to be paid on June 1, 2022 and the remaining balance of $19,225,000 will mature on June 1, 2023.
††† Insured by CIFG NA.
* Copyright 2003, American Bankers Association. CUSIP data herein are provided by Standard & Poor's, CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2003B Bonds and the Corporation does not make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2003B Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2003B Bonds.

The initial interest rate established by the Corporation and the applicable Broker-Dealer for each subseries** of the Auction Rate Bonds will apply to the period commencing on their date of issuance to and including the applicable initial Auction Date. Thereafter, each subseries will bear interest at an Auction Rate resulting from an Auction conducted for each Auction Period on each Auction Date in accordance with the Auction Procedures described in this Official Statement, subject to certain conditions and exceptions. Interest on each subseries of Auction Rate Bonds will be payable commencing on June 1, 2004, and on each December 1 and June 1 thereafter. The initial Auction Date and each Auction Date thereafter and the initial Broker-Dealer are set forth below for each subseries of Auction Rate Bonds. The Bank of New York will serve as Auction Agent.

Subseries	Initial Auction Date	Auction Date[(1)]	Auction Period[(2)]	Underwriter and Initial Broker-Dealer	Insurer
2003B-2	January 15, 2004	each fifth Thursday	35-day	Bear, Stearns & Co. Inc.	XL Capital
2003B-3	January 22, 2004	each fifth Thursday	35-day	Citigroup Global Markets, Inc.	XL Capital
2003B-4	January 29, 2004	each fifth Thursday	35-day	UBS Financial Services Inc.	XL Capital
2003B-5	January 8, 2004	each fifth Thursday	35-day	J.P. Morgan Securities Inc.	CIFG NA

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(1) Subject to certain conditions and exceptions as described herein.
(2) Subject to certain exceptions (See "APPENDIX J - DESCRIPTION OF AUCTION RATE PROCEDURES- Definitions-*Auction Period*").

Prospective purchasers of each subseries of Auction Rate Bonds should carefully review the Auction Procedures described in APPENDIX J, and should note that such procedures provide that (i) a Bid or Sell Order constitutes a commitment to purchase or sell Auction Rate Bonds based upon the results of an Auction, (ii) Auctions will be conducted through telephone, facsimile transmission or other similar electronic means of communication and (iii) settlement for purchases and sales will be made on the Business Day following an Auction. Beneficial interests in Auction Rate Bonds may be transferred only pursuant to a Bid or Sell Order placed in an Auction or to or through a Broker-Dealer.

The length of an Auction Period for each subseries of Auction Rate Bonds may be changed as described herein. The Auction Rate Bonds of such subseries will not be subject to mandatory tender for purchase upon a change in the length of an Auction Period; however, notice of such change will be given as further described herein and any Auction Rate Bonds that are not the subject of a specific Order shall be deemed to be subject to a Sell Order.

** The term "subseries" as used herein refers to each of the Series 2003B-1 Bonds, the Series 2003B-1C Bonds, the Series 2003B-2 Bonds, the Series 2003B-3 Bonds, the Series 2003B-4 Bonds and the Series 2003B-5 Bonds.

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

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED BY THE CORPORATION, THE STATE, OR THE UNDERWRITERS IN CONNECTION WITH ANY OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE CORPORATION, THE STATE OR THE UNDERWRITERS. THIS OFFICIAL STATEMENT DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, NOR SHALL THERE BE A SALE OF ANY OF THE SECURITIES OFFERED HEREBY BY ANY PERSON IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSON TO MAKE SUCH AN OFFER, SOLICITATION OR SALE.

This Official Statement contains information furnished by the Corporation, the State, Global Insight, the Insurers and other sources, all of which are believed to be reliable. Information concerning the State contained in "APPENDIX B- INFORMATION CONCERNING THE STATE OF NEW YORK" has been obtained from the State. The information contained under the caption "Summary of the Global Insight Report" and in "APPENDIX E - GLOBAL INSIGHT REPORT" hereto has been included in reliance upon Global Insight as an expert in econometric forecasting. Information concerning the tobacco industry and participants therein has been obtained from certain publicly available information provided by certain participants and certain other sources (see "APPENDIX F - CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY"). The participants in such industry have not provided any information to the Corporation for use in connection with this offering. In certain cases, tobacco industry information provided herein (such as market share data) may be derived from sources which are inconsistent or in conflict with each other. The Corporation has no independent knowledge of any facts indicating that the information contained in APPENDIX F hereto is inaccurate in any material respect, but has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. The information contained under the heading "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS-Bond Insurance", in "APPENDIX H–SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY OF XL CAPITAL ASSURANCE INC.", and "APPENDIX I–SPECIMEN BOND INSURANCE POLICY OF CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC." has been furnished by the Insurers. The Corporation believes this information is reliable, but the Corporation makes no representations or warranties whatsoever as to the accuracy or completeness of this information.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Corporation or the State or the matters covered by the report of Global Insight included as APPENDIX E to this Official Statement or the matters relating to the tobacco industry described in APPENDIX F since the date hereof or that the information contained herein is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party. See "CONTINUING DISCLOSURE AGREEMENTS."

This Official Statement contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Pledged Settlement Payments (see "BONDHOLDERS' RISKS" and "APPENDIX C - MASTER SETTLEMENT AGREEMENT"), the inclusion in this Official Statement of such forecasts, projections and estimates should not be regarded as a representation by the Corporation, the State, Global Insight or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

References in this Official Statement to the Act, the Indenture, the Sale Agreement, the Contract and the Continuing Disclosure Agreements do not purport to be complete. Refer to the Act, the Indenture, the Sale Agreement, the Contract and the Continuing Disclosure Agreements for full and complete details of their provisions. Copies of the Act, the Indenture, the Sale Agreement, the Contract and the Continuing Disclosure Agreements are on file with the Corporation and the Trustee.

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

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

THE SERIES 2003B 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 HAVE ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Official Statement and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2003B Bonds to potential investors is made only by means of the entire Official Statement. Terms used herein and not previously defined have the meanings ascribed to them in "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — Definitions." *For locations of definitions of certain terms used herein, see the "Index of Defined Terms."*

Overview	The Tobacco Settlement Financing Corporation (the "**Corporation**"), is issuing $2,240,415,000 aggregate principal amount of its Asset–Backed Revenue Bonds, Series 2003B (State Contingency Contract Secured) consisting of $302,180,000 Asset–Backed Revenue Bonds, Series 2003B-1 (State Contingency Contract Secured) (Fixed Rate) (the "**Series 2003B-1 Bonds**"), $1,713,235,000 Asset Backed Revenue Bonds, Series 2003B-1C (State Contingency Contract Secured) (Fixed Rate) (the "**Series 2003B-1C Bonds**" and, together with the Series 2003B-1 Bonds, the "**Fixed Rate Bonds**"), and $225,000,000 Asset–Backed Revenue Bonds, Series 2003B-2 through 2003B-5 (State Contingency Contract Secured) (Auction Rate) (the "**Auction Rate Bonds**" and, together with the Fixed Rate Bonds, the "**Series 2003B Bonds**") under the Indenture, dated as of December 1, 2003, as supplemented by the Series 2003B Supplement and including schedules thereto (collectively, the "**Indenture**"), between the Corporation and The Bank of New York, as indenture trustee (the "**Trustee**"). The Series 2003B Bonds are special obligations of the Corporation, payable from and secured by a pledge of the **"Pledged Revenues,"** which consist primarily of (i) the Pledged Settlement Payments sold by the State of New York (the **"State**") to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Sale Agreement**"), between the State and the Corporation and (ii) the payments (the "**Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Contract**"), between the State and the Corporation, in such amounts, subject to appropriation by the State Legislature, as are necessary to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Pledged Revenues Account, the Debt Service Account, the Supplemental Account and the Debt Service Reserve Account (collectively, the "**Pledged Accounts**") are insufficient therefor.
Issuer.....	The Corporation is a public benefit corporation of the State, established as a subsidiary of the State of New York Municipal Bond Bank Agency (the "**Agency**"), separate and apart from the State and created by the Tobacco Settlement Financing Corporation Act, as amended (the "**Act**").
Securities Offered	The Series 2003B Bonds are being issued pursuant to the Act and the Indenture. The Series 2003B Bonds, together with any refunding bonds issued on a parity therewith, are collectively referred to herein as the "**Bonds**". See "THE SERIES 2003B BONDS – Refunding Bonds." It is expected that the Series 2003B Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about December 2, 2003 (the "**Closing Date**"). Beneficial owners of the Series 2003B Bonds will not

	receive physical delivery of bond certificates.
Security.....	The Series 2003B Bonds are special obligations of the Corporation, payable from and secured by a pledge of the Pledged Revenues. Pursuant to the Act and the Sale Agreement, the State will sell to the Corporation, on the Closing Date, the "**Pledged Settlement Payments**," consisting of (i) fifty percent (50%) of the annual payments and strategic contribution payments (as defined herein) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received on and after January 1, 2004 and (ii) fifty percent (50%) of all Lump Sum Payments (as defined herein) received at any time on or after the date of delivery of the Series 2003B Bonds (the "**Closing Date**"), less, with respect to either (i) or (ii) above, the "**Unsold Settlement Payments**", which consist of, whenever received by the State, (i) payment of funds to the State to resolve claims relating to amounts held as of June 19, 2003 in the disputed payments account as defined in the escrow agreement under the MSA, and (ii) fifty percent (50%) of the annual payments and of all adjustments to prior payments, owed to the State on and after January 1, 2004 and prior to January 1, 2005, and of all Lump Sum Payments received at any time on and after the Closing Date and prior to January 1, 2005, but only to the extent the amount described in this clause (ii) represents the excess of such payments over the first $22,951,241 received. Such $22,951,241 constitutes Pledged Settlement Payments. The Master Settlement Agreement (the "**MSA**") was entered into by participating cigarette manufacturers (the "**PMs**"), the State and the other Settling States (as defined below) in November 1998 in the settlement of certain smoking-related litigation pursuant to which the PMs agreed to make certain payments to the Settling States (such payments as more fully described herein, the "**Tobacco Settlement Revenues**") to be made by the PMs under the MSA. The State has previously sold certain Tobacco Settlement Revenues (the "**Previously Purchased and Pledged Settlement Payments**") to the Corporation and the Corporation has assigned such Previously Purchased and Pledged Settlement Payments to a trustee ("**Series 2003A Trustee**") under a separate indenture in connection with the issuance by the Corporation of its Asset-Backed Revenue Bonds, Series 2003A (State Contingency Contract Secured) (the "**Series 2003A Bonds**"). The Series 2003A Bonds are separately secured by the Previously Purchased and Pledged Settlement Payments and a contingency contract relating thereto. No portion of the Pledged Settlement Payments or the Pledged Accounts will be available to holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments. Neither the Corporation nor the Trustee (or any future assignee or successor of the Trustee) shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or the Unsold Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to mitigate all or any part of an asserted deficiency in the Previously Purchased and Pledged Settlement Payments or the Unsold Settlement Payments from the Pledged Settlement Payments. The right of the Trustee (or any future assignee or successor of the Trustee) to receive Pledged Settlement Payments is

	equal to and on a parity with, and is not inferior or superior to, the right of Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive the Unsold Settlement Payments. The right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments is equal to and on a parity with, and shall not be inferior or superior to, the right of the Trustee (or any future assignee or successor of the Trustee) to receive the Pledged Settlement Payments. The Residual Certificate related to the Series 2003A Bonds is not available as security for the Series 2003B Bonds. Pursuant to the Contract, the State will agree to pay Contract Payments to the Corporation, subject to appropriation by the State Legislature, in such amounts as are necessary to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Pledged Accounts are insufficient therefor. The Series 2003B Bonds are additionally secured by the amounts on deposit in the Pledged Accounts. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS." **PURSUANT TO THE ACT, THE SERIES 2003B BONDS SHALL NOT CONSTITUTE A DEBT OR MORAL OBLIGATION OF THE STATE OR A STATE SUPPORTED OBLIGATION WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY PROVISION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF THE TAXING POWER OF THE STATE, AND THE STATE SHALL NOT BE LIABLE TO MAKE ANY PAYMENTS THEREON NOR SHALL ANY SERIES 2003B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER.**
Bond Insurance	The Series 2003B-2 Bonds, the Series 2003B-3 Bonds and the Series 2003B-4 Bonds will be insured by a financial guaranty insurance policy issued by XL Capital Assurance Inc. ("**XL Capital**") simultaneously with the delivery of the Series 2003B Bonds. The Series 2003B-5 Bonds will be insured by a financial guaranty insurance policy issued by CDC IXIS Financial Guaranty North America, Inc. ("**CIFG NA**" and, together with XL Capital, the "**Insurers**") simultaneously with the delivery of the Series 2003B Bonds. See "BOND INSURANCE."
Use of Proceeds	Pursuant to the Sale Agreement, the Corporation will deliver the net proceeds of the Series 2003B Bonds to the State as the purchase price of the Pledged Settlement Revenues to be applied by the State for the funding of authorized purposes. The balance of the proceeds of the Series 2003B Bonds will be applied: (i) to fund the Debt Service Reserve Account at its required amount, (ii) to pay certain costs of issuance relating to the Series 2003B Bonds, (iii) to fund the interest on the Series 2003B Bonds payable on June 1, 2004 and a portion of the interest on the Series 2003B Bonds payable on December 1, 2004 and (iv) to fund operating costs of the Corporation.

Master Settlement Agreement	The MSA was entered into on November 23, 1998 among the attorneys general of the 46 states (including the State), Puerto Rico, Guam, the U.S. Virgin Islands, the District of Columbia, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and the four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company* ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation* ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**"). According to Loews Corporation ("**Loews**"), the parent company of Lorillard, the OPMs accounted for approximately 92.3%† of the United States domestic cigarette market in 2002 based upon shipments. The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past and present smoking-related claims 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, Annual Payments and Strategic Contribution Payments, each as defined herein), and the imposition of certain tobacco advertising and marketing restrictions, among other things. The Corporation 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 such term is defined below). The MSA permits tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies other than OPMs that become parties to the MSA 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 MASTER SETTLEMENT AGREEMENT."
Payments Pursuant to the MSA	Under the MSA, the OPMs are required to pay to the Settling States the Tobacco Settlement Revenues consisting of (i) five initial payments (the "**Initial Payments**"), all of which have been received by the State, free and clear of the lien of the Indenture, (ii) annual payments (the "**Annual Payments**") which are required to be made annually on each April 15, having commenced April 15, 2000, and continuing in perpetuity and (iii) ten Strategic Contribution Payments (the "**Strategic Contribution Payments**"), which are required to be made annually on each April 15, commencing April 15, 2008 through April 15, 2017. SPMs are also required to make Annual Payments and Strategic Contribution Payments in certain circumstances. See "SUMMARY OF THE MASTER

* On October 27, 2003, R.J. Reynolds Tobacco Holdings, Inc. and British American Tobacco p.l.c. announced the signing of a definitive agreement to combine the assets and operations of their respective U.S. tobacco businesses. R.J. Reynolds Tobacco Holdings, Inc. stated in its Form 10-Q filed with the SEC (defined herein) for the three-month period ending September 30, 2003, that the agreement provides for establishing a new publicly traded holding company, and that the transaction is expected to close in the first half of 2004. See Appendix F—"CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY".

† The manufacturers' market share information based upon shipments as reported by Loews may be different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Initial Payments, Annual Payments and Strategic Contribution Payments and is different from that utilized in the bond structuring assumptions. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT –Initial Payments," "–Annual Payments" and "–Strategic Contribution Payments" and "SUMMARY OF PLEDGED SETTLEMENT PAYMENT METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

	SETTLEMENT AGREEMENT – Subsequent Participating Manufacturers." The Initial Payments, Annual Payments and Strategic Contribution Payments due under the MSA are subject to numerous adjustments, some of which are material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions for amounts paid by OPMs to four states that 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 in the case of the Annual Payments and the Strategic Contribution Payments. Final Approval of the MSA occurred on August 12, 1999. Upon Final Approval, Citibank N.A., as the escrow agent appointed pursuant to the MSA (the "**MSA Escrow Agent**"), distributed the up-front Initial Payment, and since then has distributed the remaining Initial Payments and the Annual Payments due April 15, 2000, April 15, 2001, April 15, 2002 and April 15, 2003 to the Settling States that achieved State-Specific Finality. None of the payments previously distributed to the State, other than certain adjustments thereto received on and after January 1, 2004, are pledged to the holders of the Bonds and such previous payments have been paid directly to the State, free and clear of the lien of the Indenture. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Payments Made to Date."
New York Consent Decree	Pursuant to the allocation percentages set forth in the MSA, the State is entitled to 12.7620310% of the total amount of Annual Payments (prior to adjustments). In addition, pursuant to the procedures agreed to in the MSA, the State is entitled to receive 5.4873402% of the total amount of Strategic Contribution Payments (prior to adjustments). The "**Consent Decree**," which was entered in the Supreme Court of the State of New York for the County of New York in December 1998, allocates to the State 100% of the Strategic Contribution Payments and 51.176% of the Annual Payments (which represents 6.5310970% of the Annual Payments payable under the MSA). The remaining 48.824% of Annual Payments is allocated among The City of New York and all other counties located within the State. The "**State's Share**" of such payments consists of the Strategic Contribution Payments and Annual Payments so allocated to the State and received by the State on or after January 1, 2004.
Sale of Pledged Settlement Payments.....	Pursuant to the Act and the Sale Agreement, the State will sell the Pledged Settlement Payments to the Corporation on the Closing Date. Under the Indenture, the Corporation will assign and pledge the Pledged Settlement Payments to the Trustee. Such Pledged Settlement Payments will be paid directly by the MSA Escrow Agent to the Trustee and the Trustee shall cause the Pledged Settlement Payments to be deposited under the Indenture. After the sale of the Pledged Settlement Payments to the Corporation, such payments will not be subject to appropriation by the State. The purchase consideration to be paid by the Corporation to the State under the Sale Agreement will consist of the net proceeds of the Series 2003B Bonds and the Residual Certificate.

	The Corporation's right to receive Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to, the right of the Series 2003A Trustee (or any future assignee or any successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive the Unsold Settlement Payments. None of the Corporation, the Trustee, any beneficiary, or any other person or entity shall have the right to make a claim to receive any portion of a perceived deficiency in Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments and likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to make up all or any portion of a perceived deficiency in the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments from the Pledged Settlement Payments.
Contract	Pursuant to the Contract, the State, acting through the Director of Budget of the State of New York, will enter into the Contract to provide additional security for the Series 2003B Bonds. The Contract contains the agreement of the State, subject to the making of annual appropriation therefor by the State Legislature, for the payment to the Corporation on or before each Distribution Date of such amount, if any, as shall be necessary to provide for the payment of the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds scheduled to be paid on such date, if the amounts on deposit in the Pledged Accounts are insufficient therefor. The Corporation will covenant to request from the State annually by certification of an Authorized Officer thereof to the Director of the Budget, by October 31st of each year, but in any event not later than December 15 of each year, an appropriation of an amount equal to the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds scheduled to come due during the next succeeding Fiscal Year. For purposes of such certification, it will be assumed that the Auction Rate Bonds will bear interest during such Fiscal Year at the maximum rate applicable thereto (15%). The State will covenant that the Director of the Budget on behalf of the State shall include, as a requested appropriation item in the State's budget for such Fiscal Year, an amount equal to such certified amount. Payments made by the State pursuant to the Contract are only available to pay the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. In no event shall payments made by the State pursuant to the Contract be available to the holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments. The proposed form of the Contract to be executed on or before the delivery of the Series 2003B Bonds is attached hereto as APPENDIX A. If, on the fifth Business Day preceding any Distribution Date, the sum of the amounts on deposit to the credit of the Pledged Accounts shall be less than the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds payable or scheduled to be payable on such Distribution Date, then the Trustee shall cause written notice thereof, and demand for payment of an amount necessary to eliminate any such deficiency, to be promptly submitted on behalf of the Corporation to the Director of the Budget of the State pursuant to the terms of the Contract,

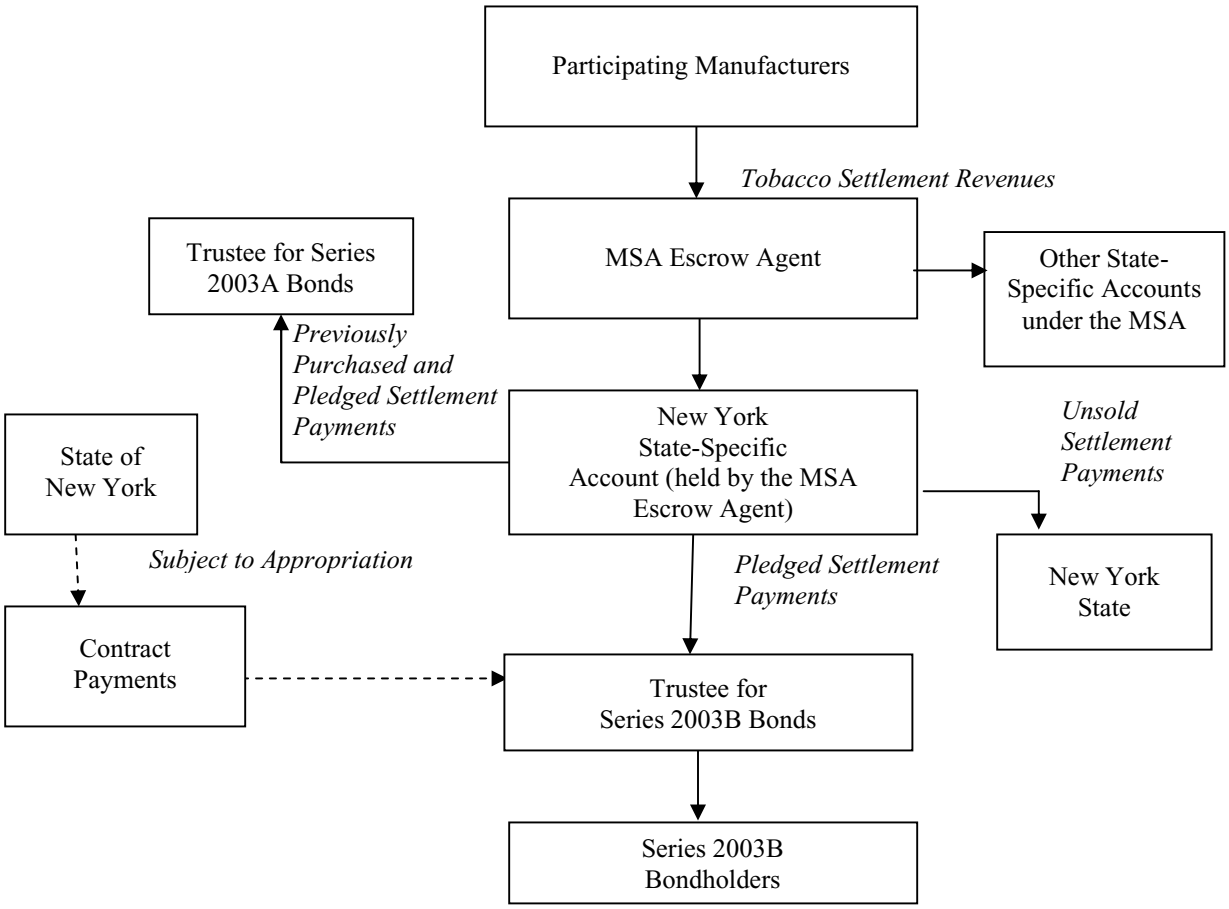
	such payment to be received in any event on or before such Distribution Date, and any amounts paid pursuant to the Contract shall be deposited directly to the credit of the Debt Service Account for the purpose of paying the debt service coming due on such Distribution Date. **PURSUANT TO THE ACT, THE SERIES 2003B BONDS SHALL NOT CONSTITUTE A DEBT OR MORAL OBLIGATION OF THE STATE OR A STATE SUPPORTED OBLIGATION WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY PROVISION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF THE TAXING POWER OF THE STATE, AND THE STATE SHALL NOT BE LIABLE TO MAKE ANY PAYMENTS THEREON NOR SHALL ANY SERIES 2003B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER. SEE "APPENDIX A – PROPOSED FORM OF THE CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION."**
Debt Service Reserve Account	A reserve account (the "**Debt Service Reserve Account**") will be established and held by the Trustee and will be funded from proceeds of the Series 2003B Bonds in an amount equal to $221,582,343.75 (the "**Debt Service Reserve Requirement**"). The balance in the Debt Service Reserve Account must be maintained, to the extent of available investment earnings therein and Pledged Settlement Payments, at the Debt Service Reserve Requirement. Contract Payments will not be applied to satisfy any deficiencies in the Debt Service Reserve Account. Amounts on deposit in the Debt Service Reserve Account will be available to pay the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent amounts on deposit in the Debt Service Account and the Supplemental Account are insufficient for such purpose. In no event shall amounts on deposit in the Debt Service Reserve Account be available to the holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments.
Supplemental Account.....	An account (the "**Supplemental Account**") will be established and held by the Trustee and will be funded from Pledged Settlement Payments in excess of those required to make the deposits required by clauses (i) through (vi) of paragraph (A) set forth herein under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS – Flow of Funds" (the "**Surplus Pledged Revenues**"). Amounts on deposit in the Supplemental Account may be used to purchase, redeem or defease Bonds as set forth under the caption "THE SERIES 2003B BONDS – Redemption and Purchase Provisions - *Application of Surplus Pledged Revenues*." Amounts on deposit in the Supplemental Account will not be released from the lien of the Indenture until (i) applied to the purchase, redemption, or defeasance of Bonds, (ii) applied to the payment of principal and Sinking Fund Installments of or interest on Bonds to the extent amounts on deposit in the Debt Service Account are insufficient therefor or (iii) there are no Bonds Outstanding under the Indenture. In addition, between April 15 and the next succeeding June 1 or December 1 in each year, no amounts in the Supplemental Account shall

be applied or set aside to defease Bonds or to pay the optional redemption or purchase price of Bonds unless there is held in the Pledged Revenues Account and the Debt Service Account sufficient amounts to pay all principal and Sinking Fund Installments of and interest on Bonds scheduled to be paid on or before such June 1 or December 1 Distribution Date.

In no event shall amounts on deposit in the Supplemental Account be available to the holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments.

Flow of Funds to the Trustee ..... The MSA Escrow Agent will disburse the Pledged Settlement Payments from the New York State-Specific Account directly to the Trustee. Additionally, the State will pay any Contract Payments, to the extent funds have been appropriated for such purposes, directly to the Trustee in accordance with the provisions of the Contract.

The following diagram depicts the flow of the State's Share of Tobacco Settlement Revenues and Contract Payments.



Auction Rate, Auction Dates, Auction Periods and Distribution Dates.....	The initial interest rate established by the Corporation and the Broker-Dealer for each subseries of the Auction Rate Bonds will apply to the period commencing on their date of issuance to and including the applicable initial Auction Date. Thereafter, each subseries will bear interest at the Auction Rate resulting from an Auction conducted for each Auction Period on each Auction Date in accordance with the Auction Procedures described in this Official Statement, subject to certain conditions and exceptions. Each subseries of the Auction Rate Bonds may bear a different Auction Rate and be subject to a different Auction Period. Interest on each subseries of Auction Rate Bonds will be payable commencing on the initial Distribution Date, and on each Distribution Date thereafter. The Initial Auction Date and each Auction Date thereafter and the initial Broker-Dealer are shown on page (ii) of this Official Statement for each subseries of Auction Rate Bonds. See "THE SERIES 2003B BONDS – Additional Information With Respect to Auction Rate Bonds" and "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES."
Optional Redemption and Purchase...	The Series 2003B-1 Bonds are not subject to optional redemption. The Series 2003B-1C Bonds maturing on June 1, 2009 and June 1, 2010 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2005, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date. The Series 2003B-1C Bonds maturing on June 1, 2011 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2006, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date. The Series 2003B-1C Bonds maturing on June 1, 2012 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2007, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date. The Series 2003B-1C Bonds maturing on June 1, 2013 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2008, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2014 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2009, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2015 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2010, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2016 and June 1, 2017 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2011, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2018 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2012, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2019, June 1, 2020, June 1, 2021 and June 1, 2022 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2013, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Auction Rate Bonds are subject to redemption at the Corporation's option, exercised at the direction of the State (which direction shall specify the subseries and maturities of the Auction Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date, without premium, in whole or in part on the Business Day immediately following the last day of an Auction Period, provided such redemption is pro rata among subseries of Auction Rate Bonds with the same maturity.

All optional redemptions may be made from Surplus Pledged Revenues on deposit in the Supplemental Account, from sources other than Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation.

	The Corporation, at the direction of the State (which direction shall specify the subseries and maturities of the Series 2003B Bonds to be purchased), may cause the Trustee to purchase Series 2003B Bonds in the open market from Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2003B Bonds being purchased at such time, plus accrued interest thereon.
Application of Surplus Pledged Revenues.....	Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase, redeem or defease Bonds (at the times, with such maturities and in such amounts as the State directs, and by lot if within a maturity) in accordance with the provisions set forth herein under the sub-captions "THE SERIES 2003B BONDS-Redemption and Purchase Provisions - *Optional Redemption", "-Purchase of Outstanding Bonds", and "-Mandatory Redemption of All Outstanding Bonds".* To the extent not used to purchase, redeem or defease Bonds, all Surplus Pledged Revenues will remain in the Supplemental Account until (i) applied to the payment of principal of or interest on Bonds to the extent amounts on deposit in the Debt Service Account are insufficient therefor or (ii) there are no Bonds Outstanding under the Indenture. In addition, between April 15 and the next succeeding June 1 or December 1 in each year, no amounts in the Supplemental Account shall be applied or set aside to defease Bonds or to pay the optional redemption or purchase price of Bonds unless there is held in the Pledged Revenues Account and the Debt Service Account sufficient amounts to pay all principal of and interest on the Bonds scheduled to be paid on or before such June 1 or December 1 Distribution Date. The State currently intends to direct all or a significant portion of the Surplus Pledged Revenues to redeem, purchase or defease Bonds but has no obligation to do so and has reserved its right to do otherwise at any time or from time to time. See "TABLE OF PROJECTED SETTLEMENT PAYMENTS AND DEBT SERVICE" for the projection of Surplus Pledged Revenues. This projection is based upon, among other things, the Base Case Forecast of cigarette consumption shown in the Global Insight Report and shows a significant amount of Surplus Pledged Revenues. The actual amounts of Surplus Pledged Revenues may be more or less than such projections of Surplus Pledged Revenues. See "BONDHOLDERS' RISKS" and see "APPENDIX E-GLOBAL INSIGHT REPORT" for a discussion of the other consumption forecasts prepared by Global Insight. There can be no assurance of the actual amounts of Surplus Pledged Revenues or the application thereof to the redemption, purchase or defeasance of Bonds.
Mandatory Sinking Fund Redemption.....	The "**Sinking Fund Installment**" of the Series 2003B-4 Bond represents the amount of principal the Corporation will pay as of the specified Distribution Date, as set forth in the schedule under "THE SERIES 2003B BONDS – Mandatory Sinking Fund Redemption" herein. Failure to pay the full amount of a Sinking Fund Installment when due is an Event of Default. See "THE INDENTURE – Events of Default" herein.

Mandatory Redemption of All Outstanding Bonds.....	On the tenth (10^{th}) day of the calendar month preceding each Distribution Date, the Trustee is required to compare (a) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (other than amounts set aside for the payment of Bonds) to (b) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts required by clauses (i) through (vi) of paragraph (B) set forth herein under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS – Flow of Funds" on such Distribution Date, and if the amount in clause (a) is greater than the amount described in clause (b) as of such Distribution Date, then, the Bonds are subject to mandatory redemption and the Trustee is required to liquidate the investments in the Pledged Accounts and to withdraw from the Pledged Accounts an amount sufficient to redeem the Bonds in full on such Distribution Date and to apply such amount to redeem the Bonds at a redemption price equal to 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption.
Events of Default	For a description of the Events of Default under the Indenture and the remedies available therefor, see "THE SERIES 2003B BONDS − Events of Default and Remedies." In no event shall principal of any Bond be declared due and payable in advance of its stated maturity.
Distributions and Priorities	The Trustee will deposit all Pledged Revenues in the Pledged Revenues Account and distribute them in accordance with the "Flow of Funds" set forth herein under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS."
Refunding Bonds	The Indenture provides that additional series of bonds may be issued by the Corporation solely for refunding purposes (each, a "**Series**") only upon receipt by the Corporation and the Trustee of a Contingency Contract for such refunding Bonds. Additional refunding Bonds would be issued on a parity with the Series 2003B Bonds. See "THE SERIES 2003B BONDS – Refunding Bonds." No other additional bonds may be issued under the Indenture with a parity claim against the Pledged Revenues.
Covenants	Pursuant to the Act and the Sale Agreement, the State has covenanted for the benefit of the Bondholders, among other things, that it will not in any way impair the rights and remedies of the Bondholders or the security for the Bonds. The Corporation and the State have covenanted not to impair the exclusion of interest on the Series 2003B Bonds from gross income for federal income tax purposes. See "APPENDIX A – PROPOSED FORM OF CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION" and "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – Summary of the Indenture" for a summary of the covenants made by the Corporation. See "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – Summary of the Sale Agreement" for a summary of the covenants made by the State. See "APPENDIX A – PROPOSED FORM OF CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION" for the covenants made by the State.
Continuing Disclosure Agreements ...	The Corporation and the State have agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any public or private repository or entity designated by

	the State as a repository for purposes of Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission certain annual financial information and operating data and, in a timely manner, notices of certain material events. See "CONTINUING DISCLOSURE AGREEMENTS" herein.
Ratings.....	Standard & Poor's Ratings Services ("**S&P**") has rated the uninsured Series 2003B Bonds "AA-" and the Insured Series 2003A Bonds "AAA". Fitch, Inc. ("**Fitch**") has rated the uninsured Series 2003B Bonds "A+" and the Insured Series 2003B Bonds "AAA".
Legal Considerations Relating to Pledged Settlement Payments.....	Reference is made to "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" for a description of certain legal issues relevant to an investment in the Series 2003B Bonds.
Bondholders' Risks.....	Reference is made to "BONDHOLDERS' RISKS" for a description of certain considerations relevant to an investment in the Series 2003B Bonds.

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INTRODUCTORY STATEMENT

Terms used herein and not previously defined have the meanings ascribed to them in "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — Definitions."

This Official Statement sets forth information concerning the issuance by the Corporation of $2,240,415,000 aggregate principal amount of its Asset-Backed Revenue Bonds, Series 2003B (State Contingency Contract Secured) consisting of $302,180,000 Asset–Backed Revenue Bonds, Series 2003B-1 (State Contingency Contract Secured) (Fixed Rate) (the "Series 2003B-1 Bonds"), $1,713,235,000 Asset Backed Revenue Bonds, Series 2003B-1C (State Contingency Contract Secured) (Fixed Rate) (the "Series 2003B-1C Bonds" and, together with the Series 2003B-1 Bonds, the "Fixed Rate Bonds"), and $225,000,000 Asset-Backed Revenue Bonds, Series 2003B-2 through 2003B-5 (State Contingency Contract Secured) (Auction Rate) (the "Auction Rate Bonds" and, together with the Fixed Rate Bonds, the "Series 2003B Bonds").

The Corporation is a public benefit corporation of the State, established as a subsidiary of the State of New York Municipal Bond Bank Agency (the "**Agency**") and created and empowered to effectuate the purposes of the Act. By the terms of the Act, the Corporation shall be treated and accounted for as a legal entity separate from the State with its separate corporate purposes set forth in the Act. The directors of the Agency serve as members of the Corporation. The Corporation is governed by a seven member board: the Chairman of the Agency, the Secretary of State, the Director of the Budget of the State, three directors appointed by the Governor of the State and the State Comptroller or his appointee. For additional information regarding the organization and management of the Corporation, see "THE CORPORATION."

The Series 2003B Bonds are special obligations of the Corporation issued under the Indenture, dated as of December 1, 2003, as supplemented by the Series 2003B Supplement and including the schedules thereto (collectively, the "**Indenture**"), between the Corporation and The Bank of New York, as indenture trustee (the "**Trustee**"). The Series 2003B Bonds are payable from and secured by a pledge of the **"Pledged Revenues**,**"** which consist of (i) the Pledged Settlement Payments sold by the State to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Sale Agreement**"), between the State and the Corporation, (ii) the payments (the "**Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Contract**"), between the State and the Corporation, in such amounts, subject to appropriation by the State Legislature, as are necessary to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Pledged Revenues Account, the Debt Service Account, the Supplemental Account and the Debt Service Reserve Account (collectively, the "**Pledged Accounts**") are insufficient therefor, (iii) payments made to the Corporation or Trustee under any Ancillary Contracts and swap contracts and (iv) all fees, charges, payments, investment earnings and other income and receipts (including proceeds of the Series 2003B Bonds, but only to the extent deposited in the Debt Service Reserve Account or the Debt Service Account) paid or payable to the Corporation or the Trustee for the account of the Corporation or the Beneficiaries. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS."

Pursuant to the Act and the Sale Agreement, the State will sell to the Corporation, on the Closing Date, the "**Pledged Settlement Payments,**" consisting of (i) fifty percent (50%) of the annual payments and strategic contribution payments (as defined herein) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received on and after January 1, 2004 and (ii) fifty percent (50%) of all Lump Sum Payments (as defined herein) received at any time on or after the date of delivery of the Series 2003B Bonds (the "**Closing Date**"), less, with respect to either (i) or (ii) above, the "**Unsold Settlement Payments**", which consist of, whenever received by the State, (i) payment of funds to the State to resolve claims relating to amounts held as of June 19, 2003 in the disputed payments account as defined in the escrow agreement under the MSA, and (ii) fifty percent (50%) of the annual payments, and of all adjustments to prior payments, owed to the State on and after January 1, 2004 and prior to January 1, 2005, and of all Lump Sum Payments received at any time on and after the Closing Date and prior to January 1, 2005, but only to the extent the amount described in this clause (ii) represents the excess of such payments over the first $22,951,241 received. Such $22,951,241 constitutes Pledged Settlement Payments. The Master Settlement Agreement (the "**MSA**") was entered into by participating cigarette manufacturers (the "**PMs**"), the State, 45 other states and six other U.S. jurisdictions (collectively, the "**Settling**

States"), in November 1998 in the settlement of certain smoking-related litigation pursuant to which the PMs agreed to make certain payments to the Settling States (such payments as more fully described herein, the "**Tobacco Settlement Revenues**"). See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS – The Sale Agreement" and "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – The Sale Agreement."

Under the Indenture, the Series 2003B Bonds are, and any other Series of refunding Bonds will be, payable solely from and secured by a statutory pledge of the Pledged Revenues, including without limitation, the Pledged Settlement Payments and Contract Payments. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS."

The State has previously sold certain Tobacco Settlement Revenues consisting of (i) fifty percent (50%) of the annual payments and strategic contribution payments and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 (other than the payment of funds to the State to resolve claims relating to amounts held as of June 19, 2003 in the Disputed Payments Account), and (ii) fifty percent (50%) of all Lump Sum Payments (other than the payment of funds to the State to resolve claims relating to amounts held as of June 19, 2003 in the Disputed Payments Account) received at any time on or after June 19, 2003 which results in, or is due to, a release of a PM from all or a portion of such payment obligations due on and after January 1, 2004 under the MSA (the "**Previously Purchased and Pledged Settlement Payments**") to the Corporation and the Corporation has assigned the Previously Purchased and Pledged Settlement Payments to a trustee (the "**Series 2003A Trustee**") under a separate indenture in connection with the issuance by the Corporation of its Asset-Backed Revenue Bonds, Series 2003A (State Contingency Contract Secured) (the "**Series 2003A Bonds**"). The Series 2003A Bonds are separately secured by the Previously Purchased and Pledged Settlement Payments and a Contingency Contract relating thereto. No portion of the Pledged Settlement Payments or the Pledged Accounts will be available to holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments. The right of the Trustee (or any future assignee or successor of the Trustee) to receive Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to, the right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments or the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments. The right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments is equal to and on a parity with, and shall not be inferior or superior to, the right of the Trustee (or any future assignee or successor of the Trustee) to receive the Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments. Neither the Corporation nor the Trustee (or any future assignee or successor of the Trustee) shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to mitigate all or any part of an asserted deficiency in the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments from the Pledged Settlement Payments. The Residual Certificate related to the Series 2003A is Bonds not available as security for the Series 2003B Bonds.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS

Set forth below is a narrative description of certain contractual and statutory provisions relating to the sources of payments and security for the Series 2003B Bonds issued under the Indenture. These provisions have been summarized and this description does not purport to be complete. Reference should be made to the Act, the Indenture, the Sale Agreement and the Contract for a more complete description of such provisions. Copies of the Act, the Indenture, the Sale Agreement and the Contract are on file with the Corporation and the Trustee. See also "APPENDIX A- PROPOSED FORM OF THE CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION" and "APPENDIX G- DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS" for a more complete statement of the rights, duties and obligations of the parties thereto.

The Series 2003B Bonds

The Series 2003B Bonds are special obligations of the Corporation, secured and payable solely from the Pledged Revenues, consisting of (i) the Pledged Settlement Payments sold by the State to the Corporation pursuant to the Sale Agreement, (ii) the Contract Payments to be made by the State pursuant to the Contract in such amounts, subject to appropriation by the State Legislature, as are necessary to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Pledged Accounts are insufficient therefor, (iii) payments made to the Corporation or Trustee under any Ancillary Contracts and swap contracts and (iv) all fees, charges, payments, investment earnings and other income and receipts (including proceeds of the Series 2003B Bonds, but only to the extent deposited in the Debt Service Reserve Account or the Debt Service Account) paid or payable to the Corporation or the Trustee for the account of the Corporation or the Beneficiaries. The Pledged Revenues and the right to receive them have been pledged to the Trustee for the benefit of the Holders of the Series 2003B Bonds. The right of the Trustee (or any future assignee or successor of the Trustee) to receive Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to, the right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments. The right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments is equal to and on a parity with, and shall not be inferior or superior to, the right of the Trustee (or any future assignee or successor of the Trustee) to receive the Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments.

Under the Act, the State is not liable on the Series 2003B Bonds. Pursuant to the Act, the Series 2003B Bonds do not constitute a debt or a moral obligation of the State or a State supported obligation within the meaning of any constitutional or statutory provision or a pledge of the faith and credit of the State or of the taxing power of the State, and the State is not liable to make any payments thereon nor are any Series 2003B Bonds payable out of any funds or assets other than the Pledged Revenues. The Corporation has no taxing power.

The Sale Agreement

Pursuant to the Act and the Sale Agreement, the State will sell to the Corporation on the Closing Date the Pledged Settlement Payments, consisting of (i) fifty percent (50%) of the annual payments and strategic contribution payments (as defined herein) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received on and after January 1, 2004 and (ii) fifty percent (50%) of any payment received by the Trustee as a payment from a PM which results in, or is due to, a release of that PM from all or a portion of its obligations due on and after January 1, 2004 under the MSA (each a "**Lump Sum Payment**") received at any time on or after the Closing Date, less, with respect to either (i) or (ii) above, the Unsold Settlement Payments. The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.† See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Initial Payments," "– Annual Payments" and "–Strategic Contribution Payments." These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material.

The MSA Escrow Agent will disburse Pledged Settlement Payments directly to the Trustee. The disbursement of Pledged Settlement Payments is required to be made to the Trustee by the MSA Escrow Agent 10 business days after the MSA Escrow Agent receives the related Annual Payments and Strategic Contribution Payments from the PMs. The Trustee will transfer the Pledged Settlement Payments to the Pledged Revenues Account established by the Indenture. Pledged Settlement Payments will be disbursed from the Pledged Revenues Account in accordance with the provisions of the Indenture. See "Flow of Funds" below.

† Other payments that are required to be made by the PMs, such as payments of attorneys' fees and payments to a national foundation established pursuant to the MSA, are not sold by the State and are not available to the Corporation and consequently are not discussed herein.

The right of the Corporation to receive the Pledged Settlement Payments, on and after the Closing Date, is valid and enforceable, and during the period the Pledged Settlement Payments are payable to the Corporation and pledged under the Indenture, the right of the Trustee (or any future assignee or successor of the Trustee) to receive Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to, the right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments or the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments. The right of the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments is equal to and on a parity with, and shall not be inferior or superior to, the right of the Trustee (or any future assignee or successor of the Trustee) to receive the Pledged Settlement Payments and the right of the State (or any future assignee or any future purchaser of the Unsold Settlement Payments) to receive Unsold Settlement Payments. Neither the Corporation nor the Trustee (or any future assignee or successor of the Trustee) shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to mitigate all or any part of an asserted deficiency in the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments from the Pledged Settlement Payments.

The Sale Agreement contains certain representations and covenants of the State for the benefit of the holders of the Series 2003B Bonds. See "COVENANTS OF THE STATE" and "APPENDIX G- DEFINITIONS AND SUMMARY OF THE TRANSACTION DOCUMENTS – The Sale Agreement" for a more detailed discussion of such representations and covenants.

The Contract

The Series 2003B Bonds are secured by a pledge of all of the Corporation's interest under the Contract, including, without limitation, the Contract Payments made by the State thereunder. The Contract provides for payment to the Corporation on or before each June 1, December 1 or other Distribution Date of such amount, if any, as shall be necessary to provide for the payment of principal and Sinking Fund Installments of and interest on the Series 2003B Bonds coming due on such date, if all other funds pledged and available therefor, as described herein, are inadequate. The Contract provides that the State's obligation to make the payments due thereunder is absolute and unconditional, and shall be deemed executory only to the extent of the moneys available to the State and no liability shall be incurred by the State beyond the moneys available and appropriated for such purpose. The Contract further provides that neither the Corporation nor the State will terminate the Contract for any reason, including any acts or circumstances which may constitute failure of consideration or frustration of purpose or the failure of either party to perform and observe any duty, liability or obligation arising out of or connected with the Contract.

The Director of the Budget on behalf of the State has agreed in the Contract to include in the appropriation bill submitted by the Governor to the State Legislature each year for the ensuing fiscal year, as a requested appropriation item, an amount equal to the amount of principal and Sinking Fund Installments of and interest on the Series 2003B Bonds coming due in such ensuing fiscal year. The Contract provides that, with respect to the amount of requested appropriation for the Auction Rate Bonds, the amount of interest thereon shall be assumed to be at the Maximum Rate as set forth in the Indenture (15%). The obligations of the State pursuant to the Contract shall not terminate so long as any Series 2003B Bond is Outstanding.

The obligation of the State to fund or pay the amounts provided for by the Contract is subject to and dependent upon annual appropriations being made by the State Legislature for such purpose, and pursuant to the Act, shall not constitute a debt or moral obligation of the State or a State supported obligation within the meaning of any Constitutional or statutory provision or a pledge of the faith and credit of the State or of the taxing power of the State, and the State shall not be liable to make any payments thereon beyond moneys available for the purposes thereof. The Corporation has no taxing power.

Simultaneously with the delivery of the Series 2003B Bonds, the State Attorney General will deliver an opinion that (i) the Act has been duly enacted by the State and is in full force and effect and (ii) the Contract has been duly authorized, executed and delivered by the State, and assuming the due execution and delivery by the Corporation, the Contract constitutes a legal, valid and binding obligation of the State, enforceable in accordance with its terms.

For a more detailed discussion of the provisions of the Contract, see "SUMMARY OF THE CONTRACT." A copy of the proposed form of the Contract is attached hereto as APPENDIX A.

Pledged Accounts

Each of the following accounts will be established under the Indenture as a segregated trust account and held by the Trustee for the benefit of the holders of the Bonds. All moneys on deposit in the following accounts will be invested in Eligible Investments as defined in the Indenture.

Pledged Revenues Account. The Trustee will establish the "**Pledged Revenues Account**" into which the Trustee will deposit all Pledged Revenues. Funds on deposit in the Pledged Revenues Account will be transferred to various other accounts under the Indenture and applied to certain other purposes as described below.

Debt Service Account. The Trustee will establish the "**Debt Service Account**" into which the Trustee will deposit amounts transferred from the Pledged Revenues Account in respect of principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. The Trustee will make payments on the Series 2003B Bonds in accordance with the priority of payments as described below under "Flow of Funds."

Debt Service Reserve Account. The Trustee will establish the "**Debt Service Reserve Account**" to be funded on the Closing Date from Series 2003B Bond proceeds in the amount of $221,582,343.75 (the "**Debt Service Reserve Requirement**"). To the extent of available investment earnings therein and Pledged Settlement Payments, the balance in the Debt Service Reserve Account must be maintained at the Debt Service Reserve Requirement. Contract Payments will not be applied to satisfy any deficiencies in the Debt Service Reserve Account.

Amounts in the Debt Service Reserve Account will be available to pay principal and Sinking Fund Installments of and interest on the Series 2003B Bonds to the extent that amounts on deposit in the Debt Service Account and the Supplemental Account are insufficient for such purpose. All earnings on amounts in the Debt Service Reserve Account will be retained in it if the amount therein is not equal to the Debt Service Reserve Requirement. On each Distribution Date, amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be transferred to the Pledged Revenues Account and from there immediately to the Debt Service Account.

In no event shall amounts on deposit in the Debt Service Reserve Account be available to the holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments.

Supplemental Account. The Trustee will establish the "**Supplemental Account**" into which the Trustee will deposit Pledged Settlement Payments in excess of those required to make the deposits required by clauses (i) through (vi) of paragraph (A) set forth below under the sub-caption "Flow of Funds" (the "**Surplus Pledged Revenues**"). Amounts on deposit in the Supplemental Account may be used to purchase, redeem or defease Bonds as set forth under the caption "THE SERIES 2003B BONDS – Redemption and Purchase Provisions - *Application of Surplus Pledged Revenues*."

Amounts on deposit in the Supplemental Account will not be released from the lien of the Indenture until (i) applied to the purchase, redemption or defeasance of Bonds, (ii) applied to the payment of principal and Sinking Fund Installments of or interest on Bonds to the extent amounts on deposit in the Debt Service Account are insufficient therefor or (iii) there are no Bonds Outstanding under the Indenture.

In no event shall amounts on deposit in the Supplemental Account be available to the holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments.

In addition, between April 15 and the next succeeding June 1 or December 1 in each year, no amounts in the Supplemental Account shall be applied or set aside to defease Bonds or to pay the optional redemption or purchase price of Bonds unless there is held in the Pledged Revenues Account and the Debt Service Account sufficient amounts to pay all principal and Sinking Fund Installments of and interest on Bonds scheduled to be paid on or before such June 1 or December 1 Distribution Date.

Additional Accounts

Each of the following accounts will be established under the Indenture and held by the Trustee. None of these accounts is a Pledged Account and amounts on deposit therein are not available to pay principal and Sinking Fund Installments of and interest on the Bonds.

Costs of Issuance Account. The Trustee will establish the "**Costs of Issuance Account**" into which the Trustee will deposit amounts funded from the proceeds of Bonds, and will disburse such amounts for Costs of Issuance. Amounts in the Costs of Issuance Account certified by the Corporation as being in excess of required Costs of Issuance will be transferred to the Pledged Revenues Account.

Operating Account. The Trustee will establish the "**Operating Account**" into which the Trustee will deposit amounts transferred from the Pledged Revenues Account as set forth in the Officers' Certificate as Operating Expenses and from which the Trustee will pay Operating Expenses in accordance with the priority of payments as described below under "Flow of Funds."

Rebate Account. The Trustee will establish the "**Rebate Account**" into which the Trustee will deposit amounts to the extent required to satisfy the Rebate Requirement (as defined, computed and provided to the Trustee in accordance with the Tax Certificate), for payment to the United States Treasury.

Flow of Funds

Except as provided in the Indenture and described in paragraph (A) below, the Trustee will deposit all Pledged Payments in the Pledged Revenues Account. To the extent that the Trustee shall in error have received Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments, the Trustee shall within one (1) Business Day remit such Unsold Settlement Payments to or for the account of the State and any such Previously Purchased and Pledged Settlement Payments to or for the account of the Series 2003A Bonds Trustee. Subject to the foregoing, amounts deposited during the period January 1 through June 30 in any Fiscal Year will be applied to expenses and debt service requirements on the Bonds for the then current period from July 1 through June 30 (each period from July 1 through the following June 30, a "**Bond Year**"), and for the first half of the next Bond Year. Amounts, if any, deposited during the period July 1 through December 31 in any Bond Year will be applied to expenses and debt service requirements on the Bonds for the current Bond Year.

As used herein, the term "**Deposit Date**" means the date of actual receipt by the Trustee of any Pledged Revenues, provided that any payment received prior to January 1 of the year in which due will be deemed to have been received on January 1.

(A) No later than five Business Days following each deposit of Pledged Revenues to the Pledged Revenues Account (but in no event later than the next Distribution Date), the Trustee will withdraw Pledged Revenues on deposit in the Pledged Revenues Account and transfer such amounts as follows and in the following order of priority; provided, however, that (x) payments received on Swap Contracts and investment earnings on amounts in the funds and accounts (other than the Debt Service Reserve Account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the Debt Service Reserve Requirement, and on the Business Day preceding each Distribution Date amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement shall be transferred to the Pledged Revenues Account, and from there, immediately to the Debt Service Account) will be deposited directly to the Debt Service Account and (y) the Contract Payments, whether or not an Event of Default has occurred, will be deposited directly to the Debt Service Account.

(i) (a) to the Trustee the amount required to pay the Trustee fees and expenses (including reasonable attorneys' fees, if applicable) due, and not previously paid or funded, during the current Fiscal Year and, if the Deposit Date is during the period from May 1 through October 31 of any year, during the first full six months of the next Fiscal Year and (b) to the Operating Account, an amount specified by an Officer's Certificate for all operating and administrative expenses incurred by the Corporation and the Agency (related to its activities on behalf of the Corporation) (the "**Operating Expenses**") (provided that such amounts paid pursuant to clauses (a) and (b) shall not exceed the Operating Cap[†] and Operating Expenses will not include any termination payments, term-out payments or loss amounts on Ancillary Contracts or Swaps), in each case for the current Fiscal Year and, if the Deposit Date is between May 1 and October 31, for the first full six months of the following Fiscal Year; provided that amount required to pay any portion of the State Fee (defined below) in connection with the Series 2003B Bonds shall not be deposited to the Operating Account unless it is specified in an Officer's Certificate that sufficient amounts have been deposited in the Debt Service Account (exclusive of any transfers from the Debt Service Reserve Account pursuant to the Indenture) to meet all principal and interest funding requirements set forth in clause (ii) and (iii) below for the period ending on (but not including) December 1, 2004 (transfers to the Operating Account for the State Fee in connection with any Series of Refunding Bonds may include similar restrictions, as set forth in the applicable Series Supplement);

(ii) to the Debt Service Account an amount sufficient to cause the amount on deposit therein (together with interest and earnings reasonably expected by the Corporation to be received on investments in the Debt Service Account on or prior to the next succeeding Distribution Date, as evidenced by an Officer's Certificate), to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due on the next succeeding Distribution Date, and, in the case of interest due at variable rates on Bonds, to deposit in separate subaccounts within the Debt Service Account, Bond interest due during the Semiannual Period including such Distribution Date, together with any unpaid interest due on prior Distribution Dates, pro rata, based upon the respective amounts of interest due; provided that with respect to Auction Rate Bonds, the deposit will be based on actual interest which can be computed as of the transfer date assuming that for any period for which interest cannot be calculated, the Auction Rate Bonds will bear interest at a constant rate equal to the Presumed Auction Rate; and provided, further, that with respect to the Series 2003B Bonds, unless the Trustee is otherwise instructed by an Officer's Certificate, any calculation pursuant to this clause (ii) of interest due on Auction Bonds made on any day in the period from the Closing Date to May 31, 2004 (inclusive) and the period from June 2, 2004 to November 30, 2004 (inclusive) shall be based on the Presumed Auction Rate, and any calculation made on June 1, 2004 and December 1, 2004 shall be based on actual interest rates on the Auction Bonds during the period ending on said June 1, 2004 and December 1, 2004,

(iii) to the Debt Service Account an amount sufficient to cause the amount on deposit therein (together with interest and earnings reasonably expected by the Corporation to be received on investments in the Debt Service Account on or prior to the next succeeding Distribution Date, as evidenced by an Officer's Certificate) exclusive of the amount on deposit therein or credited thereto pursuant to clause (ii) above, to equal the principal and Sinking Fund Installments due during the current Fiscal Year;

[†] The "**Operating Cap**" is the sum of (i) in connection with the issuance of the Series 2003B Bonds, the one-time fee payable in one or more installments (without interest), owing to the State from Pledged Revenues in an amount not exceeding $22,951,241.00, (ii) in connection with the issuance of any Series of Refunding Bonds, the one-time fee, payable in one or more installments (without interest), owing to the State from Pledged Revenues, in an amount not exceeding that set forth in the applicable Series Supplement (such fees collectively referred to as the "**State Fee**"), (iii) $500,000.00 in the Fiscal Year ending October 31, 2004 and adjusted for inflation in subsequent Fiscal Years, (iv) any arbitrage and rebate penalties, the amount of Broker-Dealer fees calculated as set forth in the Indenture and (v) in each Fiscal Year, annual bond insurance premiums and fees and charges of the State in addition to the State Fee that are payable by the Corporation after the Closing Date.

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

(v) to the Debt Service Account the amount which, together with the amounts deposited or credited pursuant to clause (ii) above, exclusive of amounts deposited therein or credited thereto pursuant to clause (iii) above, will be sufficient to cause the amount on deposit therein (together with interest and earnings reasonably expected by the Corporation to be received on investments in the Debt Service Account on or prior to the next succeeding Distribution Date, as evidenced by an Officer's Certificate) to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due (a) during the current Bond Year and (b) if the Deposit Date is during the period from January 1 through June 30 of any year, during the first full six months of the next Bond Year (or, in the case of variable rate Bonds, during the first complete Semiannual Period in such next Bond Year), assuming that principal and Sinking Fund Installments of the Bonds will be paid in the amounts deposited pursuant to clause (iii) above;

(vi) in the amounts and to the funds and accounts established by the Series Supplement for (a) termination payments and loss amounts on Ancillary Contracts and any payments on Swap Contracts, (b) Bond principal payable under term-out provisions of Ancillary Contracts, (c) other amounts due under Ancillary Contracts and not payable as debt service, (d) annual payments required to be paid by the Corporation pursuant to subdivisions 2 and 3 of Section 2975 of the Public Authorities Law, (e) litigation expenses incurred by the Corporation and (f) any other junior payments, but not in excess of $500,000 in the aggregate for any Fiscal Year, identified as such by the Indenture (the "**Junior Payments**"); and

(vii) to the Supplemental Account, all Surplus Pledged Revenues.

In calculating deposits to the Accounts established under the Indenture, payments by the Corporation under Swap Contracts providing for variable rate payments and interest on variable-rate Bonds (other than Auction Bonds) shall be assumed at the Maximum Rate; and such deposits for such payments shall be transferred to the Pledged Revenues Account pursuant to Officer's Certificates reporting accruals at the actual rates.

On each December 31 and each April 15, the Trustee shall calculate the amount of cash and investments on deposit in the Pledged Accounts. On or before (i) each January 5 (based on the preceding December 31 calculation) and (ii) April 20 (based on the preceding April 15 calculation), the Trustee shall notify the Corporation and the State as to whether such amounts are sufficient to pay all principal and Sinking Fund Installments of and interest on the Bonds scheduled to be paid on the next succeeding June 1 and December 1.

(B) On each Distribution Date (except with respect to clauses (i) and (ii)(a) below), the Trustee will apply amounts in the various accounts in the following order of priority:

(i) at any time, from the Operating Account, to the parties entitled thereto, to pay Operating Expenses in the amount specified in an Officer's Certificate;

(ii) from the Debt Service Account (a) at any time, as directed in an Officer's Certificate, to the Pledged Revenues Account any balance therein in excess of the amount required to be on deposit therein pursuant to clause (A)(ii) above, and (b) to pay interest on the Outstanding Bonds (including interest on overdue interest, if any) due on such Distribution Date, plus any unpaid interest due on prior Distribution Dates (and to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Debt Service Account from the Supplemental Account and the Debt Service Reserve Account, in that order);

(iii) from the Debt Service Account (and to the extent that amounts in the Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Debt Service Account from the Supplemental Account and the Debt Service Reserve Account, in that

order), to pay, in order of maturity dates, the principal and Sinking Fund Installments and Sinking Fund Installments due on such Distribution Date;

(iv) from the Debt Service Reserve Account, any amount in excess of the Debt Service Reserve Requirement to the Pledged Revenues Account and from there immediately to the Debt Service Account;

(v) from the Funds and Accounts established by Series Supplement, to make Junior Payments; and

(vi) from the Supplemental Account, to one or more separate subaccounts therein, to provide irrevocably for the payment of Bonds in accordance with the Indenture or to pay the optional redemption or purchase price of Bonds to be redeemed or purchased on such Distribution Date.

BOND INSURANCE

The Series 2003B-2 Bonds, the Series 2003B-3 Bonds and the Series 2003-4 Bonds will be insured by a financial guaranty insurance policy issued by XL Capital Assurance Inc. ("**XL Capital**") simultaneously with the delivery of the Series 2003B Bonds. The Series 2003B-5 Bonds will be insured by a financial guaranty insurance policy issued by CDC IXIS Financial Guaranty North America, Inc. ("**CIFG NA**" and, together with XL Capital, the "**Insurers**") simultaneously with the delivery of the Series 2003B Bonds. The following information has been provided by the Insurers for inclusion in this Official Statement.

XL Capital Assurance Inc.

General. Simultaneously with the issuance of the Series 2003B Bonds, XL Capital Assurance Inc. ("**XL Capital**") will issue its financial guaranty insurance policy (the "**XL Capital Policy**") for the Series 2003B-2 Bonds, the Series 2003B-3 Bonds and the Series 2003-4 Bonds (the "**XL Capital Insured Bonds**"). The XL Capital Policy guarantees the scheduled payment of principal, including Sinking Fund Installments, of and interest on the XL Capital Insured Bonds when due as set forth in the form of the XL Capital Insurance Policy included as APPENDIX H to this Official Statement.

The following information has been supplied by XL Capital for inclusion in this Official Statement. No representation is made by the Corporation as to the accuracy or completeness of the information.

XL Capital accepts no responsibility for the accuracy or completeness of this Official Statement or any other information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding XL Capital and its affiliates set forth under this heading. In addition, XL Capital makes no representation regarding the XL Capital Insured Bonds or the advisability of investing in the XL Capital Insured Bonds.

XL Capital is a monoline financial guaranty insurance company incorporated under the laws of the State. XL Capital is currently licensed to do insurance business in, and is subject to the insurance regulation and supervision by, the State, forty-seven other states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Singapore. XL Capital has license applications pending, or intends to file an application, in each of those states in which it is not currently licensed.

XL Capital is an indirect wholly owned subsidiary of XL Capital Ltd, a Cayman Islands corporation ("**XL Capital Ltd**"). Through its subsidiaries, XL Capital Ltd is a leading provider of insurance and reinsurance coverages and financial products to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis. The common stock of XL Capital Ltd is publicly traded in the United States and listed on the New York Stock Exchange (NYSE: XL). **XL Capital Ltd is not obligated to pay the debts of or claims against XL Capital.**

XL Capital was formerly known as The London Assurance of America Inc. ("**London**"), which was incorporated on July 25, 1991 under the laws of the State. On February 22, 2001, XL Reinsurance America Inc.

("**XL Re**") acquired 100% of the stock of London. XL Re merged its former financial guaranty subsidiary, known as XL Capital Assurance Inc. (formed September 13, 1999) with and into London, with London as the surviving entity. London immediately changed its name to XL Capital Assurance Inc. All previous business of London was 100% reinsured to Royal Indemnity Company, the previous owner at the time of acquisition.

Reinsurance. XL Capital has entered into a facultative quota share reinsurance agreement with XL Financial Assurance Ltd ("**XLFA**"), an insurance company organized under the laws of Bermuda, and an affiliate of XL Capital. Pursuant to this reinsurance agreement, XL Capital expects to cede up to 90% of its business to XLFA. XL Capital may also cede reinsurance to third parties on a transaction-specific basis, which cessions may be any or a combination of quota share, first loss or excess of loss. Such reinsurance is used by XL Capital as a risk management device and to comply with statutory and rating agency requirements and does not alter or limit XL Capital's obligations under any financial guaranty insurance policy. With respect to any transaction insured by XL Capital, the percentage of risk ceded to XLFA may be less than 90% depending on certain factors including, without limitation, whether XL Capital has obtained third party reinsurance covering the risk. As a result, there can be no assurance as to the percentage reinsured by XLFA of any given financial guaranty insurance policy issued by XL Capital, including the XL Capital Policy.

Based on the audited financials of XLFA, as of December 31, 2002, XLFA had total assets, liabilities, redeemable preferred shares and shareholders' equity of $611,791,000, $245,750,000, $39,000,000 and $327,041,000, respectively, determined in accordance with generally accepted accounting principles in the United States. XLFA's insurance financial strength is rated "Aaa" by Moody's Investors Service, Inc. ("**Moody's**"), and "AAA" by S&P and Fitch. In addition, XLFA has obtained a financial enhancement rating of "AAA" from S&P.

The obligations of XLFA to XL Capital under the reinsurance agreement described above are unconditionally guaranteed by XL Insurance (Bermuda) Ltd ("**XLI**"), a Bermuda company and one of the world's leading excess commercial insurers. XLI is a wholly owned indirect subsidiary of XL Capital Ltd. In addition to having an "A+" rating from A.M. Best, XLI's financial strength rating is "Aa2" by Moody's and "AA" by S&P and Fitch. The ratings of XLFA and XLI are not recommendations to buy, sell or hold securities, including the XL Capital Bonds and are subject to revision or withdrawal at any time by Moody's, S&P or Fitch.

Notwithstanding the capital support provided to XL Capital described in this section, the Bondholders will have direct recourse against XL Capital only, and neither XLFA nor XLI will be directly liable to the Bondholders.

Financial Strength and Financial Enhancement Ratings of XLCA. XL Capital's insurance financial strength is rated "Aaa" by Moody's and "AAA" by S&P and Fitch. In addition, XL Capital has obtained a financial enhancement rating of "AAA" from S&P. These ratings reflect Moody's, S&P and Fitch's current assessment of XL Capital's creditworthiness and claims-paying ability as well as the reinsurance arrangement with XLFA described under "*Reinsurance*" above.

The above ratings are not recommendations to buy, sell or hold securities, including the XL Capital Insured Bonds and are subject to revision or withdrawal at any time by Moody's, S&P or Fitch. Any downward revision or withdrawal of these ratings may have an adverse effect on the market price of the XL Capital Insured Bonds. XL Capital does not guaranty the market price of the XL Capital Insured Bonds nor does it guaranty that the ratings on the XL Capital Insured Bonds will not be revised or withdrawn.

Capitalization of XL Capital. Based on the audited statutory financial statements for XL Capital as of December 31, 2001, XL Capital had total admitted assets of $158,442,157, total liabilities of $48,899,461 and total capital and surplus of $109,542,696 determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities ("**SAP**"). Based on the audited statutory financial statements for XL Capital as of December 31, 2002 filed with the State of New York Insurance Department ("**NYSID**"), XL Capital has total admitted assets of $180,993,189, total liabilities of $58,685,217 and total capital and surplus of $122,307,972 determined in accordance with SAP.

For further information concerning XL Capital and XLFA, see the financial statements of XL Capital and XLFA, and the notes thereto. The financial statements of XL Capital and XLFA are included as exhibits to the periodic reports filed with the Securities and Exchange Commission (the "**SEC**"), by XL Capital Ltd and may be

reviewed at the EDGAR website maintained by the Commission. Copies of the statutory quarterly and annual statements filed with the NYSID by XL Capital are available upon request to the NYSID.

Regulation of XL Capital. XL Capital is regulated by the Superintendent of Insurance of the State. In addition, XL Capital is subject to regulation by the insurance laws and regulations of the other jurisdictions in which it is licensed. As a financial guaranty insurance company licensed in the State, XL Capital is subject to Article 69 of the New York Insurance Law, which, among other things, limits the business of each insurer to financial guaranty insurance and related lines, prescribes minimum standards of solvency, including minimum capital requirements, establishes contingency, loss and unearned premium reserve requirements, requires the maintenance of minimum surplus to policyholders and limits the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. XL Capital is also required to file detailed annual financial statements with the NYSID and similar supervisory agencies in each of the other jurisdictions in which it is licensed.

The extent of state insurance regulation and supervision varies by jurisdiction, but the State and most other jurisdictions have laws and regulations prescribing permitted investments and governing the payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

THE FINANCIAL GUARANTY INSURANCE POLICIES ISSUED BY XL CAPITAL, INCLUDING THE XL CAPITAL POLICY, ARE NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

The principal executive offices of XL Capital are located at 1221 Avenue of the Americas, New York, New York 10020 and its telephone number at this address is (212) 478-3400.

CDC IXIS Financial Guaranty North America, Inc.

General. Simultaneously with the issuance of the Series 2003B Bonds, CIFG NA will issue its financial guaranty insurance policy (the "**CIFG NA Policy**") for the Series 2003B-5 Bonds (the "**CIFG NA Insured Bonds**"). The CIFG NA Policy guarantees the scheduled payment of principal of and interest on the CIFG NA Insured Bonds when due as set forth in the form of the CIFG NA Policy included as APPENDIX I to this Official Statement.

The following information has been supplied by CIFG NA for inclusion in this Official Statement. No representation is made by the Corporation as to the accuracy or completeness of the information.

CIFG NA is a monoline financial guaranty insurance company incorporated under the laws of the State, with its principal place of business in New York City.

The claims-paying ability (also referred to as its financial strength) of CIFG NA is rated "AAA" by Fitch, "Aaa" by Moody's, and "AAA" by S&P, the highest rating assigned by each such rating agency. Each rating of CIFG NA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of CIFG NA and its ability to pay claims on its policies of insurance based upon, among other factors, the adequacy of the net worth maintenance and reinsurance agreements provided by CIFG described below under "—*Capitalization*". Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold the CIFG NA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the CIFG NA Insured Bonds. CIFG NA does not guarantee the market price of the CIFG NA Insured Bonds nor does it guaranty that the ratings on the CIFG NA Insured Bonds will not be revised or withdrawn.

CIFG NA is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State, its state of domicile, and is licensed to do business in multiple jurisdictions. CIFG NA is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that each such insurer maintain a minimum surplus to

policyholders, establishes contingency, loss and unearned premium reserve requirements for each such insurer, and limits the size of individual transactions ("single risks") and the volume of transactions ("aggregate risks") that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as CIFG NA regulate, among other things, permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings. CIFG NA is required to file quarterly and annual statutory financial statements with the NYSID and is subject to statutory restrictions concerning the types and quality of its investments and the filing and use of policy forms and premium rates. Additionally, CIFG NA's accounts and operations are subject to periodic examination by the NYSID.

THE INSURANCE PROVIDED BY THE CIFG NA POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED BY THE INSURANCE LAWS OF THE STATE.

Capitalization. In addition to capital and surplus, set forth below, CIFG NA is supported by a net worth maintenance agreement from its indirect parent, CDC IXIS Financial Guaranty, a French reinsurance corporation ("**CIFG**"). The net worth maintenance agreement provides that CIFG will maintain CIFG NA's U.S. statutory capital and surplus at no less than $80 million. In addition, through a facultative reinsurance agreement, CIFG NA may cede up to 90% of its exposure on each transaction to CIFG; however, the facultative reinsurance agreement does not require that CIFG reinsure its exposure under any transaction. At September 30, 2003, CIFG had capital of 407.3 million euros according to U.S. generally accepted accounting principles. CIFG's claims paying ability is rated "Aaa" by Moody's, "AAA" by Standard & Poor's and "AAA" by Fitch, the highest rating assigned by each such Rating Agency. *Notwithstanding these net worth maintenance and reinsurance agreements, the holders of the CIFG NA Insured Bonds will have direct recourse against CIFG NA only, and neither CIFG nor any other affiliate of CIFG NA will be directly liable to the holders of the CIFG NA Insured Bonds.*

The following table sets forth the capitalization of CIFG NA as of September 30, 2003, on the basis of accounting principles prescribed or permitted by the NYSID (in thousands):

Common capital stock	$ 19,700
Gross paid in and contributed surplus	110,925
Unassigned funds (retained deficit)	(21,164)
Surplus as regards policyholders	$109,461

CIFG NA has advised that there has been no material adverse change in the capitalization of CIFG NA from September 30, 2003 to the date of this Official Statement.

CIFG NA has prepared audited annual financial statements as of December 31, 2002 in accordance with accounting principles applicable to insurance companies, as specified by applicable law. Copies of such financial statements may be obtained at www.cifg.com, or by writing to CIFG NA at 825 Third Avenue, 6th Floor, New York, New York 10022, Attention: Finance Department. The toll-free telephone number of CIFG NA is (866) CIFG 212. Further information concerning CIFG may be found in the financial statements and the notes thereto of CIFG, which may be obtained at www.cifg.com or by writing to CIFG NA at 825 Third Avenue, 6th Floor, New York, New York 10022, Attention: Finance Department.

The CIFG NA Policy does not protect investors against changes in market value of the CIFG NA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. CIFG NA makes no representation regarding the CIFG NA Insured Bonds or the advisability of investing in the CIFG NA Insured Bonds. CIFG NA makes no representation regarding this Official Statement, nor has it participated in the preparation thereof, except that CIFG NA has provided to the Corporation the information presented under this caption for inclusion in this Official Statement.

THE SERIES 2003B BONDS

The following summary describes certain terms of the Series 2003B Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2003B Bonds. Copies of the Indenture, the Sale Agreement and the Contract may be obtained upon written request to the Trustee.

Description of the Series 2003B Bonds

The Series 2003B 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 2003B Bonds. The Series 2003B Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof, with respect to the Fixed Rate Bonds, and in denominations of $25,000 or any integral multiple thereof, with respect to the Auction Rate Bonds, in book-entry form only. Except under the limited circumstances described herein, no Beneficial Owner of the Series 2003B Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2003B Bonds. See "THE SERIES 2003B BONDS – Book-Entry Only System" below.

The Series 2003B Bonds will be issued pursuant to the Act and the Indenture, will be dated as of the Closing Date and will mature at the times and in the aggregate principal amounts set forth on pages (i) and (ii) hereof. Interest on the Series 2003B Bonds, including the Auction Rate Bonds, will be payable on each Distribution Date, commencing on June 1, 2004. The interest on the Series 2003B Bonds payable on June 1, 2004 and a portion of the interest on the Series 2003B Bonds payable on December 1, 2004 will be paid from the proceeds of the Series 2003B Bonds. For each Distribution Date, payments that are to be made on the Series 2003B Bonds will be made to holders of the Series 2003B Bonds of record (the "**Bondholders**") as of the applicable Record Date.

Interest will accrue from and including the Closing Date, or from and including the most recent Distribution Date on which interest has been paid to, but excluding, the subsequent Distribution Date. Interest on the Fixed Rate Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Interest on Auction Rate Bonds that are in an Auction Period of 180 days or less shall be calculated on the basis of a 360-day year for the actual number of days elapsed to the Distribution Date. Interest on Auction Rate Bonds that are in an Auction Period of over 180 days shall be calculated on the basis of a 360-day year consisting of twelve 30-day months.

Each subseries of the Auction Rate Bonds will bear interest in an Auction Rate Mode as herein described from and including their date of delivery to but excluding the date on which the Mode applicable to such subseries is converted to the Fixed Rate Mode for such subseries, in which event that subseries will be subject to mandatory tender for purchase on the Mode Change Date at the purchase price equal to the principal amount thereof plus accrued interest. The principal portion of the purchase price is payable only from remarketing proceeds. The Corporation has no obligation to purchase Auction Rate Bonds that are subject to mandatory tender for purchase and that have not been remarketed. If any Auction Rate Bonds are not purchased on the Mode Change Date, the Existing Owners will continue to hold all of the Auction Rate Bonds in a seven-day Auction Period at the Maximum Rate (15% per annum) for the Auction Period commencing on the failed Mode Change Date.

Redemption and Purchase Provisions

Optional Redemption

The Series 2003B-1 Bonds are not subject to optional redemption.

The Series 2003B-1C Bonds maturing on June 1, 2009 and June 1, 2010 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2005, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2011 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2006, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2012 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2007, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2013 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2008, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2014 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2009, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2015 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2010, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2016 and June 1, 2017 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2011, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2018 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2012, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Series 2003B-1C Bonds maturing on June 1, 2019, June 1, 2020, June 1, 2021 and June 1, 2022 are subject to redemption in whole or in part (and by lot within a maturity), at any time on or after June 1, 2013, at the option of the Corporation exercised at the direction of the State (which direction shall specify the maturities of the Fixed Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

The Auction Rate Bonds are subject to redemption at the Corporation's option, exercised at the direction of the State (which direction shall specify the subseries and maturities of the Auction Rate Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date, without premium, in whole or in part on the Business Day immediately following the last day of an Auction Period, provided such redemption is pro rata among subseries of Auction Rate Bonds with the same maturity.

All optional redemptions may be made from Surplus Pledged Revenues on deposit in the Supplemental Account, from sources other than Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation and, except as otherwise provided in the Indenture, may be made at the times, and with respect to such subseries, and such maturities and in such amounts as the State directs, and by lot if within a maturity of a subseries.

Mandatory Sinking Fund Redemption

The Series 2003B-4 Bond maturing on June 1, 2023 is subject to mandatory redemption 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:

Series 2003B-4 Bonds
Maturing June 1, 2023

Year	Sinking Fund Installments
2022	$50,775,000
2023†	19,225,000

† Final maturity.

There shall be applied to or credited against any sinking fund requirement, as selected by the Corporation at its option, the principal amount of any Series 2003B Bonds subject to redemption therefrom that have been purchased or optionally redeemed and not previously so applied or credited. Series 2003B Bonds purchased by the Corporation shall be promptly tendered to the Trustee for cancellation. See APPENDIX G—"DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS—Redemption of the Bonds".

Purchase of Outstanding Bonds

The Corporation, at the direction of the State (which direction shall specify the subseries and maturities of the Series 2003B Bonds to be purchased), may cause the Trustee to purchase Series 2003B Bonds in the open market from Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2003B Bonds being purchased at such time, plus accrued interest thereon.

Application of Surplus Pledged Revenues

Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase or redeem Bonds in accordance with the provisions set forth above under the sub-captions "*Optional Redemption*" and "*Purchase of Outstanding Bonds*" and in accordance with the provision set forth below under the sub-caption "*Mandatory Redemption of All Outstanding Bonds*" or to defease Bonds (of such subseries and maturity as shall be directed by the State and by lot within a maturity). To the extent not used to purchase, redeem or defease Bonds, all Surplus Pledged Revenues will remain in the Supplemental Account until (i) applied to the payment of principal and Sinking Fund Installments of or interest on Bonds to the extent amounts on deposit in the Debt Service Account are insufficient therefor or (ii) there are no Bonds Outstanding under the Indenture. In addition, between April 15 and the next June 1 or December 1 in each year, no amounts in the Supplemental Account shall be applied or set aside to defease Bonds or to pay the optional redemption or purchase price of Bonds unless there is held in the Debt Service Account sufficient amounts to pay all principal and Sinking Fund Installments of and interest on Bonds scheduled to be paid on or before such June 1 or December 1 Distribution Date.

The State currently intends to direct all or a significant portion of the Surplus Pledged Revenues to redeem, purchase or defease Bonds but has no obligation to do so and has reserved its right to do otherwise at any time or from time to time. See "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE" for the projection of Surplus Pledged Revenues. This projection is based upon, among other things, the Base Case Forecast of cigarette consumption shown in the Global Insight Report and shows a significant amount of Surplus Pledged Revenues. The actual amounts of Surplus Pledged Revenues may be more or less than such projection of Surplus Pledged Revenues. See "BONDHOLDERS' RISKS" and see "APPENDIX E- GLOBAL INSIGHT REPORT" for a discussion of the other consumption forecasts prepared by Global Insight. There can be no assurance of the actual amounts of Surplus Pledged Revenues or the application thereof to the redemption, purchase or defeasance of Bonds.

Partial Redemption

Except as stated above with respect to the Auction Rate Bonds, if less than all the Outstanding Bonds of like subseries, maturity date and interest rate are to be redeemed, the particular Bonds to be redeemed shall be selected by the Trustee by such method as it shall deem fair and appropriate 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. The Trustee shall redeem any and all Bonds held by the provider of an Ancillary Contract prior to redeeming any other Bonds unless otherwise directed by an Officer's Certificate of the Corporation.

Mandatory Redemption of All Outstanding Bonds

On the tenth (10^{th}) day of the calendar month preceding each Distribution Date, the Trustee is required to compare (a) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (other than amounts set aside for the payment of Bonds) to (b) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts required by clauses (i) through (vi) of paragraph (B) set forth herein under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS – Flow of Funds" on such Distribution Date, and if the amount in clause (a) is greater than the amount described in clause (b) as of such Distribution Date, then, the Bonds are subject to mandatory redemption and the Trustee is required to liquidate the investments in the Pledged Accounts and to withdraw from the Pledged Accounts an amount sufficient to redeem the Bonds in full on such Distribution Date and to apply such amount to redeem the Bonds at a redemption price equal to 100% of the principal amount thereof to be redeemed, plus interest accrued thereon to the date fixed for redemption.

Notice of Redemption

Fifteen days' notice shall be given to holders of the Series 2003B Bonds to be redeemed prior to maturity. On and after any date of redemption, interest will cease to accrue on any Series 2003B Bonds called for redemption.

Refunding Bonds

The Corporation may authorize, issue, sell and deliver Bonds from time to time in such principal amounts as the Corporation may determine but solely to refund Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine. Subsequent to the issuance of the Series 2003B Bonds, only Refunding Bonds may be issued and only upon receipt by the Corporation or the Trustee of a Contingency Contract for such Refunding Bonds.

Events of Default and Remedies

Events of Default

The Indenture provides that each of the following shall be an "**Event of Default**" thereunder:

(i) principal and Sinking Fund Installments of or interest on any Bond has not been paid when due;

(ii) the Corporation fails to observe or perform any other provision of the Indenture which failure is not remedied within 60 days after written notice thereof has been given to the Corporation by the Trustee or to the Corporation and the Trustee by the holders of at least 25% of the principal amount of the Outstanding Bonds, provided that if the default cannot be corrected within the said 60-day period and is diligently pursued until corrected, it shall not constitute an Event of Default if corrective action is instituted by the Corporation within said 60-day period and diligently pursued until the default is corrected;

(iii) the State fails to observe or perform its covenants described herein under "APPENDIX G-DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS– The Indenture–

Agreement with the State" or "– The Sale Agreement– *Covenants of the State,*" which failure is not remedied within 60 days after written notice thereof has been given to the Corporation and the State by the Trustee or to the Corporation and the Trustee by holders of not less than 25% of the principal amount of the Outstanding Bonds;

(iv) the State fails to provide the amounts demanded by the Trustee for payment of principal and Sinking Fund Installments of or interest on the Bonds in accordance with the Indenture;

(v) the failure of the Director of the Budget on behalf of the State, prior to the commencement of any fiscal year of the State, to include as a requested appropriation item in the State's budget for such fiscal year, an amount equal to the principal and Sinking Fund Installments of and interest on the Bonds scheduled to come due during such fiscal year; or

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

Remedies

If an Event of Default occurs the Trustee may, and upon written request of the holders of 25% in principal amount of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with the law:

(i) enforce all rights of the holders and require the Corporation or, to the extent permitted by law, the State to carry out its agreements with the holders and to perform its duties under the Sale Agreement;

(ii) sue upon such Bonds;

(iii) require the Corporation to account as if it were the trustee of an express trust for the holders of such Bonds; and

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

In no event shall the outstanding principal of any Bond be declared due and payable in advance of its stated maturity.

Additional Information With Respect To Auction Rate Bonds

Unless the context otherwise indicates, references in the following description to the "Auction Rate Bonds" apply to each subseries of the Auction Rate Bonds independently. Actions may be taken, or determinations made, with respect to one subseries that are not taken or made with respect to any other. See also "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES."

General

Auction Rate Bonds. The Auction Rate Bonds will be dated as of the Closing Date and will mature at the times and in the principal amounts as set forth on page (ii) of this Official Statement. The Auction Rate Bonds initially will be in an Auction Rate Mode. While in an Auction Rate Mode, the Auction Rate Bonds will bear interest at an interest rate determined as described below under "Determination of Interest Rates and Auction Periods for Auction Rate Bonds". **This Official Statement, in general, describes the Auction Rate Bonds only during the Auction Rate Mode**.

Interest on Auction Rate Bonds that are in an Auction Period of 180 days or less will be calculated on the basis of a 360-day year for the actual number of days elapsed to the Distribution Date. Interest on Auction Rate Bonds that are in an Auction Period of over 180 days will be calculated on the basis of a 360-day year consisting of twelve 30-day months.

Interest Payments. Interest on the Auction Rate Bonds is payable on each Distribution Date as described below under the caption "Determination of Interest Rates and Auction Periods for Auction Rate Bonds – *Distribution Dates."* So long as DTC is the sole registered owner of all of the Auction Rate Bonds, all interest payments will be made to DTC by wire transfer of immediately available funds, and DTC's participants will be responsible for payment of interest to beneficial owners. All Auction Rate Bonds are fully registered in Authorized Denominations.

Transfers and Exchanges. So long as DTC is the securities depository for the Auction Rate Bonds, it will be the sole registered owner of the Auction Rate Bonds, and transfers of ownership interests in the Auction Rate Bonds will occur through the DTC Book-Entry Only System.

Determination of Interest Rates and Auction Periods for Auction Rate Bonds

The initial interest rate for each subseries of the Auction Rate Bonds will be established by the Corporation and the applicable Broker-Dealer and will apply to the period commencing on the Closing Date to and including the initial Auction Date specified below for each such subseries. Thereafter, each subseries of the Auction Rate Bonds will bear interest at an Auction Period Rate (as defined below) determined on each Auction Date for each Auction Period pursuant to the Auction Procedures set forth in APPENDIX J. Each subseries of the Auction Rate Bonds may bear a different Auction Rate and be subject to a different Auction Period. The Auction Period and Auction Date applicable to a subseries of the Auction Rate Bonds will be the Auction Period and Auction Date set forth below until the length of such Auction Period is changed to a daily, seven-day, 28-day, 35-day, three-month, six-month or Special Auction Period, as described below under "*Change in the Length of the Auction Period*."

Subseries	Initial Auction Date	Auction Date*	Auction Period**	Underwriter and Initial Broker-Dealer	Insurer
2003B-2	January 15, 2004	each fifth Thursday	35-day	Bear, Stearns & Co. Inc.	XL Capital
2003B-3	January 22, 2004	each fifth Thursday	35-day	Citigroup Global Markets, Inc.	XL Capital
2003B-4	January 29, 2004	each fifth Thursday	35-day	UBS Financial Services Inc.	XL Capital
2003B-5	January 8, 2004	each fifth Thursday	35-day	J.P. Morgan Securities Inc.	CIFG NA

* If such day is not followed by a Business Day, the Auction Date will be the next day which is followed by a Business Day.

** Subject to certain exceptions (see "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES-Definitions-*Auction Period*.")

Auction Period Rate means with respect to each subseries of the Auction Rate Bonds, the rate of interest to be borne by that subseries during each Auction Period determined in accordance with the Indenture, which will equal the Auction Rate (as defined below and which may not exceed the Maximum Rate) for each Auction Period, subject to the following exceptions:

- If the Auction Agent fails to calculate or, for any reason, fails to timely provide the Auction Rate for any Auction Period, (a) if the preceding Auction Period was a period of 35 days or less, the new Auction Period and Auction Period Rate will be the same as the preceding Auction Period and the Auction Period Rate, respectively, and (b) if the preceding Auction Period was a period of greater than 35 days, it will be extended to the seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business

Day then to the next succeeding day which is followed by a Business Day) and the Auction Period Rate will continue in effect for the Auction Period as so extended.

- In the event that all conditions for a conversion to a Fixed Rate Mode from an Auction Rate Mode have not been met or in the event of a failure to change the length of the current Auction Period due to lack of Sufficient Clearing Bids at the Auction on the Auction Date for the first new Auction Period, the Auction Period Rate for the next Auction Period will be the Maximum Rate (15% per annum) and the next Auction Period will be a seven-day Auction Period.

- If the Auction Rate Bonds of a subseries are not rated or if the Auction Rate Bonds of a subseries are no longer maintained in book-entry form by the Securities Depository, then the Auction Period Rate will be the Maximum Rate.

"**Auction Rate**" means, for each subseries of Auction Rate Bonds for each Auction Period, the interest rate that the Auction Agent advises results from an Auction conducted in accordance with the Auction Procedures, which rate will be as follows:

- If Sufficient Clearing Bids exist, the Winning Bid Rate.

- If Sufficient Clearing Bids do not exist, the Maximum Rate.

- If all Auction Rate Bonds of a subseries are the subject of Submitted Hold Orders, the All Hold Rate.

In no event may the Auction Period Rate exceed the Maximum Rate. See "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES – Determination of Auction Period Rate."

Distribution Dates. With respect to the Auction Rate Bonds, Distribution Date means each June 1 and December 1, commencing June 1, 2004, or if such date is not a Business Day, the next succeeding Business Day (but only for interest accrued through the preceding last day of May or November, as the case may be).

Auction Date. An Auction to determine the interest rate for each subseries of Auction Rate Bonds for each Auction Period will be held on the initial Auction Date and each Auction Date thereafter. The initial Auction Date and each Auction Date thereafter are set forth above for each subseries of Auction Rate Bonds. In the event of a conversion from an Auction Period then applicable to a subseries of Auction Rate Bonds to another Auction Period, Auctions will be held on each Auction Date (as defined in APPENDIX J) for such new Auction Period. The day of the week on which Auctions are held may be changed by the Auction Agent in accordance with APPENDIX J. See "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES– Changes in Auction Period or Auction Date."

Auction Agent. The Trustee will enter into the Auction Agreement with The Bank of New York (the Auction Agent) pursuant to which the Auction Agent, as Agent for the Trustee, shall perform the duties of Auction Agent. The Auction Agreement will provide, among other things, that the Auction Agent will determine the Auction Rate for each Auction in accordance with the Auction Procedures set forth in APPENDIX J.

Auction Procedures. The procedure for submitting orders prior to the Submission Deadline on each Auction Date is described in APPENDIX J, as are the particulars with regard to the determination of the Auction Period Rate (collectively, the Auction Procedures). See "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES."

Change in the Length of the Auction Period. The Corporation may from time to time on any Auction Date change the length of the Auction Period with respect to all of the Auction Rate Bonds of any subseries among a daily, seven-day, 28-day, 35-day, three-month, six-month and a Special Auction Period. No such change will be effective unless Sufficient Clearing Bids existed at both the Auction before the date on which the notice of the proposed change was given and the Auction immediately preceding the proposed change. On the date of that change, any Auction Rate Bonds of such subseries which are not the subject of a specific Hold Order or Bid will be

deemed to be subject to a Sell Order. In the event of a failed conversion to another Auction Period due to the lack of Sufficient Clearing Bids, the Auction Rate Bonds of such subseries will automatically convert to a seven-day Auction Period and will bear interest for the next Auction Period at the Maximum Rate. In connection with a conversion from one Auction Period to another Auction Period, written notice of such conversion will be given in accordance with the Auction Procedures. However, the Auction Rate Bonds of a subseries will not be subject to mandatory tender on such conversion date. See "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES – Changes in Auction Period or Auction Date."

Record Date. The record date for the Auction Rate Bonds will be the Business Day immediately preceding a Distribution Date.

Special Considerations Relating to the Auction Rate Bonds in an Auction Rate Mode. The Auction Agreement provides that the Auction Agent may resign from its duties as Auction Agent by giving at least 90-days notice or, if it has not been paid, 30-days notice to the Corporation and the Trustee. The Auction Agreement does not require, as a condition to the effectiveness of such resignation, that a replacement Auction Agent be in place if its fee has not been paid. The Broker-Dealer Agreement provides that the Broker-Dealer thereunder may resign upon 30-days notice or, under certain circumstances, immediately and does not require, as a condition to the effectiveness of such resignation, that a replacement Broker-Dealer be in place. For any Auction Period during which there is no duly appointed Auction Agent, or during which there is no duly appointed Broker-Dealer, it will not be possible to hold Auctions, with the result that the interest rate on the Auction Rate Bonds will be determined as if the Auction Agent failed to calculate or timely provide the Auction Rate. For more information, see Auction Period Rate above and subsection (d) in "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES– Determination of Auction Period Rate."

The Broker-Dealer Agreement provides that a Broker-Dealer may submit an Order in Auctions for its own account. If a Broker-Dealer submits an Order for its own account, it might have an advantage over other Bidders in that it would have knowledge of Orders placed through it in that Auction. Such Broker-Dealer, however, would not have knowledge of Orders submitted by other Broker-Dealers (if any) in that Auction. In the Broker-Dealer Agreement, Broker-Dealers agree to handle customer Orders in accordance with their respective duties under applicable securities laws and rules.

During an Auction Rate Mode the beneficial owner of an Auction Rate Bond may sell, transfer or dispose of an Auction Rate Bond only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or through a Broker-Dealer. See "APPENDIX J – DESCRIPTION OF AUCTION RATE PROCEDURES." The ability to sell an Auction Rate Bond in an Auction may be adversely affected if there are not sufficient buyers willing to purchase all the Auction Rate Bonds at a rate equal to or less than the Maximum Rate. The Broker-Dealers have advised the Corporation that they intend initially to make a market in the Auction Rate Bonds of a subseries between Auctions. However, the Broker-Dealers are not obligated to make such markets, and no assurance can be given that secondary markets therefor will develop.

Conversion to Fixed Rate Mode

General. All Auction Rate Bonds of a subseries may be converted to bear interest in the Fixed Rate Mode at the times and in the manner as summarized herein.

Notice of Conversion. The Corporation will give written notice of the conversion to the Trustee, the Broker-Dealer and the Auction Agent (the "**Notice Parties**") of its intention to convert the Bonds to a Fixed Rate Mode, together with the proposed effective date of such conversion. Such notice will be given at least seven Business Days prior to the conversion date.

General Provisions Applying to Fixed Rate Conversion

1. The conversion date must be the Business Day immediately following the final Auction Period.

2. Together with the notice to the Notice Parties described above, the Corporation must file with the Trustee a Favorable Opinion of Bond Counsel to the effect that the conversion to the Fixed Rate will not adversely affect the validity of the Auction Rate Bonds or any exclusion from gross income for federal income tax purposes to which interest on the Auction Rate Bonds would otherwise be entitled.

3. No conversion to the Fixed Rate will occur unless the Corporation has also filed with the Trustee a Favorable Opinion of Bond Counsel to the same effect dated the conversion date.

4. The Trustee is required to mail a notice of the proposed conversion to the Owners of all Auction Rate Bonds to be converted not less than twenty (20) days prior to the proposed conversion date.

5. Not later than 12:00 noon, New York City time, on the Business Day prior to the conversion date, the Remarketing Agent will determine the fixed interest rate for the Auction Rate Bonds to be converted. The "**Remarketing Agent**" means the firm retained by the Corporation to remarket the Auction Rate Bonds on their conversion to a Fixed Rate Mode.

6. Such determination will be conclusive and binding upon the Corporation, the Trustee, the Broker-Dealer, the Auction Agent and the Owners of the Auction Rate Bonds to which such rate will be applicable. Not later than 5:00 p.m., New York City time, on the date of determination of the fixed rate, the Remarketing Agent will notify the Trustee of such rate by telephone.

7. The Corporation may revoke its election to effect a conversion of the interest rate on the Auction Rate Bonds to the Fixed Rate Mode by giving written notice of such revocation to the Trustee, the Auction Agent and the Broker-Dealer at any time prior to 10:00 a.m., New York City time, on the Business Day immediately preceding the proposed conversion date and an Auction for such Auction Rate Bond will be held on such date as if no notice of conversion had been given.

8. Prior to the conversion of any of the Auction Rate Bonds to a Fixed Rate Mode, the Remarketing Agent will deliver to the Trustee and the Corporation a Redemption Terms Certificate specifying the redemption provisions to be applicable to the Auction Rate Bonds on and after the conversion date.

9. On the conversion date applicable to any of the Auction Rate Bonds to be converted, the Auction Rate Bonds to be converted will be subject to mandatory tender at a purchase price equal to 100% of the principal amount thereof plus accrued interest. The principal portion of the purchase price of the Auction Rate Bonds subject to such mandatory tender is payable solely from the proceeds of the remarketing of such converted Auction Rate Bonds. If on the proposed conversion date any condition precedent to such conversion is not satisfied, the Trustee will give written notice by first class mail postage prepaid as soon as practicable and in any event not later than the next succeeding Business Day to the Owners of the Auction Rate Bonds that such conversion has not occurred, that the Auction Rate Bonds will not be purchased on the failed conversion date, that the Auction Agent will continue to implement the Auction Procedures on the Auction Date with respect to the Auction Rate Bonds that otherwise would have been converted, excluding the Auction Date falling on the Business Day next preceding the failed conversion date, and that the interest rate will continue to be the Auction Rate. However, the interest rate borne by the Auction Rate Bonds during the Auction Period commencing on such failed conversion date will be the Maximum Rate, and the Auction Period will be the seven-day Auction Period.

Book-Entry Only System

DTC, New York, New York, will act as a securities depository for the Series 2003B Bonds. The Series 2003B Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series 2003B Bond will be issued for each maturity of the Series 2003B Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC. If, however, the aggregate principal amount of any maturity of the Series 2003B Bonds exceeds $500 million, one Series 2003B Bond of such maturity will be issued with respect to each $500 million of principal amount, and an additional Series 2003B Bond will be issued with respect to any remaining principal amount of such maturity.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**" and together with Direct Participants, "**DTC Participants**"). The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Series 2003B Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2003B Bonds on DTC's records. The ownership interest of each actual purchaser of the Series 2003B Bonds (each, a "**Beneficial Owner**") is in turn to be recorded on the DTC Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the DTC Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2003B 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 2003B Bonds, except in the event that use of the book-entry system for the Series 2003B Bonds is discontinued.

To facilitate subsequent transfers, all the Series 2003B Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2003B Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2003B Bonds; DTC's records will reflect only the identity of the Direct Participants to whose accounts the Series 2003B 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.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2003B Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2003B Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2003B Bond documents. For example, Beneficial Owners of the Series 2003B Bonds may wish to ascertain that the nominee holding the Series 2003B Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds of any maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2003B Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Corporation 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 2003B 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 the Corporation, the 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 2003B Bonds are issued in book-entry form through the facilities of DTC, any Beneficial Owner desiring to cause the Corporation or the Trustee to comply with any of its obligations with respect to the Series 2003B Bonds must make arrangements with the Direct Participant or Indirect Participant through whom such Beneficial Owner's ownership interest in the Series 2003B 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 THE CORPORATION, THE TRUSTEE OR 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 2003B BONDS, THE ADHERENCE TO SUCH PROCEDURES OR ARRANGEMENTS OR THE EFFECTIVENESS OF ANY ACTION TAKEN PURSUANT TO SUCH PROCEDURES OR ARRANGEMENTS.

Redemption proceeds, distributions, and interest payments on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Corporation or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee or the Corporation, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Corporation or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of DTC Participants.

The Corporation may decide to discontinue use of the system of book-entry transfers through DTC (or a successor depository). In that event, certificates for the Series 2003B Bonds will be printed and delivered.

So long as Cede & Co. is the registered owner of the Series 2003B Bonds, as nominee for DTC, references in this Official Statement to Bondholders or registered owners of the Series 2003B Bonds (other than under the caption "TAX MATTERS" herein) shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of the Series 2003B Bonds.

As long as the book-entry system is used for the Series 2003B Bonds, the Trustee and the Corporation 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 2003B 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 2003B BONDS THAT MAY BE SO CONVEYED TO DIRECT PARTICIPANTS AND INDIRECT PARTICIPANTS.

If less than all of the Series 2003B Bonds of a maturity 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 2003B 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.

DTC may discontinue providing its services as securities depository with respect to the Series 2003B Bonds at any time by giving reasonable notice to the Corporation or Trustee, or the Corporation may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). Under such circumstances, in the event that a successor securities depository is not obtained, the Series 2003B Bonds are required to be printed and delivered to Beneficial Owners.

THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE CORPORATION BELIEVES TO BE RELIABLE, BUT THE CORPORATION TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE CORPORATION, THE STATE 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 AND SINKING FUND INSTALLMENTS OF OR REDEMPTION PREMIUM, IF ANY, OR INTEREST ON THE SERIES 2003B 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 OWNERS OF THE SERIES 2003B BONDS; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE SERIES 2003B BONDS; OR (6) ANY ACTION TAKEN BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER OF THE SERIES 2003B BONDS.

None of the Corporation, the State, the Trustee or the Underwriters can give any assurance that DTC or DTC Participants will distribute payments of principal and Sinking Fund Installments, premium or interest on the Series 2003B 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 Official Statement.

THE CORPORATION

General

The Corporation is a public benefit corporation of the State of New York (the "**State**"), established as a subsidiary of the State of New York Municipal Bond Bank Agency (the "**Agency**") and created pursuant to the Act.

By the terms of the Act, the Corporation is treated and accounted for as a legal entity separate from the State and the Agency with its separate corporate purposes set forth in the Act. The directors of the Agency serve as members of the Corporation. The Corporation is governed by a seven member board: the Chairman of the Agency, the Secretary of State, the Director of the Budget of the State, three directors appointed by the Governor of the State and the State Comptroller or his appointee.

The members of the Corporation are:

Name	Title
Jerome M. Becker	Chairman
Kenneth M. Bialo	Vice Chairman
Randy Daniels	*Ex officio*, Secretary of State
Carole E. Stone	*Ex officio*, Director of the Budget of the State of New York
F. Michael Stapleton	Member
Michael J. Townsend	Member
Howard C. Nolan, Jr.	Member

The officers of the Corporation are:

Name	Title
Stephen J. Hunt	Executive Director
James P. Angley	Senior Vice President
Robert M. Drillings	Senior Vice President and Counsel
Ralph J. Madalena	Senior Vice President and Chief Financial Officer
Bernard Abramowitz	Senior Vice President

The Act

The Tobacco Settlement Financing Corporation Act authorizes the Corporation to issue by July 1, 2004 an aggregate principal amount of bonds not to exceed $4,200,000,000 (plus the financing costs associated therewith, including reserves) to purchase all or a portion of the State's Share of the Tobacco Settlement Revenues. This limitation does not apply to bonds issued to refund bonds. On June 19, 2003, the Corporation issued $2,310,705,000 aggregate principal amount of its Series 2003A Bonds, which financed the purchase of the Previously Purchased and Pledged Settlement Payments. The Series 2003A Bonds were issued under a separate indenture and are separately secured by the Previously Purchased and Pledged Settlement Payments and a Contingency Contract relating thereto. No portion of the Pledged Settlement Payments and the Pledged Accounts will be available to holders of any bonds secured by the Previously Purchased and Pledged Settlement Payments. Neither the Corporation nor the Trustee (or any future assignee or successor of the Trustee) shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments, and, likewise, neither the Corporation nor the Series 2003A Trustee (or any future assignee or successor of the Series 2003A Trustee) nor the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to mitigate all or any part of an asserted deficiency in the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments from the Pledged Settlement Payments.

The Act authorizes the execution and delivery of the Contract by the State and the Corporation and establishes the basic terms thereof. In addition, the Act sets forth and authorizes the pledge and agreement of the State not to take certain actions with respect to the MSA, the Qualifying Statute and the Complementary Legislation and to enforce its right to collect moneys due from the PMs under the MSA and to diligently enforce the Qualifying Statute. See "COVENANTS OF THE STATE."

SOURCES AND USES OF FUNDS

Estimated sources and uses of funds are as follows:

Sources of Funds

Principal amount of Series 2003B Bonds	$2,240,415,000.00
Net Original Issue Premium	119,277,170.70
Total Sources	$2,359,692,170.70

Use of Funds

Payment to State	$1,998,541,495.77
Debt Service Reserve Account	221,582,343.75
Debt Service Account (capitalized interest)	114,343,526.85
Costs of Issuance (including bond insurance premiums)	9,522,016.16
Underwriters' Discount	15,190,788.17
Operating Account	512,000.00
Total Uses	$2,359,692,170.70

TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE [(1) (2)]

The following table sets forth (i) the estimated amounts required to be paid by the Corporation during each calendar year of the years shown for the payment of debt service on the Series 2003B Bonds, (ii) the projected amount of Pledged Settlement Payments[(2)] to be received by the Corporation, which projection has been calculated based on the Global Insight Base Case Forecast and other structuring assumptions and (iii) the projected amount of Surplus Pledged Revenues available to redeem, purchase or defease Outstanding Series 2003B Bonds. No assurances can be given that the Pledged Settlement Payments will be received in the amounts projected using the Global Insight Base Case Forecast and other structuring assumptions.

Year	Projected Pledged Settlement Payments[(2)]	Principal	Interest[(3)]	Total Debt Service[(3)]	Projected Debt Service Coverage Provided by Projected Pledged Settlement Payments[(2)]	Projected Surplus Pledged Revenues[(2)]
2004	$ 31,857,840[(4)]	$ 0	$ 0	$ 0	--	$ 0[(4)]
2005	215,540,173	40,250,000	113,703,008	153,953,008	1.40x	61,587,165
2006	219,029,877	44,825,000	111,623,358	156,448,358	1.40x	62,581,519
2007	222,473,946	49,440,000	109,466,308	158,906,308	1.40x	63,567,638
2008	252,638,500	73,870,000	106,583,133	180,453,133	1.40x	72,185,368
2009	256,499,659	80,515,000	102,696,798	183,211,798	1.40x	73,287,861
2010	259,743,623	87,205,000	98,321,576	185,526,576	1.40x	74,217,047
2011	263,289,956	94,435,000	93,625,064	188,060,064	1.40x	75,229,892
2012	266,830,388	101,865,000	88,724,764	190,589,764	1.40x	76,240,624
2013	270,188,998	109,680,000	83,306,239	192,986,239	1.40x	77,202,759
2014	273,461,788	118,110,000	77,217,476	195,327,476	1.40x	78,134,312
2015	276,663,378	127,100,000	70,512,564	197,612,564	1.40x	79,050,814
2016	280,394,139	137,030,000	63,248,989	200,278,989	1.40x	80,115,151
2017	284,115,963	147,475,000	55,460,454	202,935,454	1.40x	81,180,509
2018	292,570,675	161,990,000	46,985,520	208,975,520	1.40x	83,595,155
2019	296,259,489	173,860,000	37,749,645	211,609,645	1.40x	84,649,844
2020	299,858,398	186,300,000	27,880,785	214,180,785	1.40x	85,677,613
2021	303,795,966	199,690,000	17,301,600	216,991,600	1.40x	86,804,366
2022	308,033,170	212,550,000	7,436,219	219,986,219	1.40x	88,046,952
2023	307,772,060	94,225,000	1,531,156	95,756,156	3.21x	212,015,903
	$5,181,017,986	$2,240,415,000	$1,313,374,654	$3,553,789,654		$1,627,228,332

(1) Assumes that the Series 2003B Bonds are paid at maturity and that the Corporation does not exercise its right to redeem, purchase or defease the Series 2003B Bonds prior thereto.

(2) Includes Pledged Settlement Payments plus (+) earnings on the Debt Service Reserve Account at 4.168% and earnings on Pledged Settlement Payments until distributed less (-) (a) Operating Expenses inflated at a rate of 3% per annum and (b) broker dealer fees associated with the Auction Rate Bonds. The projection of Pledged Settlement Payments is based on the Global Insight Base Case Cigarette Consumption Forecast and other structuring assumptions. See "SUMMARY OF THE GLOBAL INSIGHT REPORT," "APPENDIX E – GLOBAL INSIGHT REPORT" and "SUMMARY OF PLEDGED SETTLEMENT PAYMENTS PROJECTION METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS- Collections Methodology and Assumptions."

(3) Assumes that the Auction Rate Bonds bear interest at a rate of 3.25% per annum. Interest is assumed to accrue on a 30/360 basis. Interest amounts in 2004 are shown net of interest capitalized from bond proceeds.

(4) Projected Pledged Settlement Payments in 2004 have been sized to include an amount sufficient to pay debt service on the Auction Rate Bonds at the Maximum Rate. Excess Pledged Settlement Payments after payment of total debt service are used to pay the State Fee.

The Series 2003B Bonds are further secured by a pledge of all of the Corporation's interest under the Contract, including, without limitation, the Contract Payments required to be made by the State thereunder if the Pledged Settlement Payments and amounts on deposit in the Debt Service Reserve Account and the other Pledged Accounts are inadequate to pay when due the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. The State's obligation to make Contract Payments under the Contract is subject to and dependent

upon annual appropriations being made by the State Legislature for such purpose. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS — "The Sale Agreement" and "—"Pledged Accounts" and "SUMMARY OF THE CONTRACT."

SUMMARY OF THE CONTRACT

On or before the Closing Date, the State and the Corporation will enter into the Contract to provide additional security for the Series 2003B Bonds. The Contract contains the agreement of the State, subject to the making of annual appropriation therefor by the State Legislature, for the payment to the Corporation on or before each Distribution Date of such amount, if any, as shall be necessary to provide for the payment of the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds scheduled to be paid on such date, if the amounts on deposit in the Pledged Accounts are insufficient therefor.

Terms used herein and not previously defined have the meanings ascribed to them in the Contract. The following summary describes certain terms of the Contract. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to the provisions of the Contract. See "APPENDIX A – PROPOSED FORM OF CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION."

Payments by the State

Pursuant to the Contract, the State has agreed subject to the third and fourth paragraphs below to pay to the Corporation, on or before each Distribution Date of any year for which the Corporation shall have outstanding Bonds secured by the Contract, the amount of money, if any, certified by the Chairman of the Corporation to the Director of the Budget and to the Comptroller no later than five (5) business days prior to each such Distribution Date as the amount which is necessary, after taking into account application of all amounts of Collateral pledged therefor under the Indenture, including receipts from Pledged Settlement Payments or from any other Ancillary Contract (as defined in the Indenture) or amounts in the Debt Service Account, the Debt Service Reserve Account or the Supplemental Account on the date of such certification, to pay the scheduled principal (as to which the failure to make payment thereof constitutes a default under the Indenture, including mandatory sinking fund payments, if any) of and interest on the Bonds coming due on such next succeeding Distribution Date (the "**Scheduled Debt Service**"). (Section 1.1)

In addition, the State has agreed that, subject to the third and fourth paragraphs below, its obligations to make the payments provided for in the Contract shall be absolute and unconditional, without any rights of set-off, recoupment or counterclaim the State may have against the Corporation or any other person or entity having an interest in the Contract or the payments made thereunder. (Section 1.2)

Notwithstanding anything in the Contract to the contrary, (1) the obligation of the State to fund or to pay the amounts therein provided for is subject to annual appropriation by the State Legislature, (2) the obligation of the State, to fund or to pay the amounts therein provided for shall not constitute a debt of the State, or pursuant to the Act, State supported debt, within the meaning of any constitutional or statutory provision and shall be deemed executory only to the extent of moneys available and no liability shall be incurred by the State beyond moneys available and appropriated for such purpose, and (3) the amounts paid to the Corporation pursuant to the Contract shall be applied by the Corporation solely for deposit under the Indenture to pay the Scheduled Debt Service. (Section 1.3)

The Contract shall not constitute a debt or moral obligation of the State or a State supported obligation within the meaning of any constitutional or statutory provision or a pledge of the faith and credit of the State or of the taxing power of the State, and the State shall not be liable to make any payments thereon nor shall it be payable out of any funds or assets other than those received from the State under the Contract and pledged therefor under the Indenture. (Section 1.4)

To the extent that the Corporation shall obtain bond insurance for the Series 2003B Bonds (which provides for payment to Bondholders in the event that Series 2003B Bonds are not paid from Collateral held under the

Indenture), such bond insurance shall not be pledged as Collateral to the payment of the Series 2003B Bonds or otherwise considered an Ancillary Bond Facility under the Indenture, amounts payable by the bond insurer shall not be Pledged Revenues under the Indenture, and the bond insurer shall not be a Beneficiary under the Indenture (except to the extent payments are made on the bond insurance). As a result, payments required to be made by the State pursuant to the first paragraph above shall not take into account amounts due for payment under any such bond insurance policy. (Section 1.5)

Duties of the Corporation

The Corporation has agreed to apply the net proceeds (as defined in the Act) from the sale of its Series 2003B Bonds to finance the purchase of a certain portion of the State's Share in accordance with the applicable provisions of the Act and the Indenture. (Section 2.1)

The Corporation has agreed to deposit under the Indenture all amounts received pursuant to the Contract, which amounts shall be held, administered and applied by the Trustee, as provided in the Indenture, and shall not be commingled with any other funds of the Corporation. (Section 2.2)

Pledge and Assignment

The State has consented to the pledge and assignment by the Corporation under the Indenture for the benefit of the owners of any of its Bonds of all or any part of the benefits or rights of the Corporation under the Contract and of the payments by the State as provided therein. (Section 3.1)

Special Covenants

In accordance with the Act, by October 31st in each year, but in any event not later than December 15 of each year, the Corporation has agreed to request from the State annually by certification of an authorized officer thereof an appropriation of an amount equal to the Scheduled Debt Service (provided that with respect to Auction Rate Bonds the amount of interest thereon shall be at the Maximum Rate of fifteen percent (15%) per annum as set forth in the Indenture or with respect to other Bonds, if any, for which the interest thereon is subject to variation between Distribution Dates, the amount of interest thereon shall be at the maximum rate as set forth or as provided for in the Indenture) coming due during such next succeeding fiscal year, and the State has agreed that the Director of the Budget on behalf of the State shall include, as a requested appropriation item in the State's budget for such fiscal year, an amount equal to such certified amount. (Sections 4.1 and 4.2)

The State has agreed that whenever requested by the Corporation with reasonable advance notification it shall provide and certify, or cause to be provided and certified, in form satisfactory to the Corporation, such information concerning (A)(i) the State and various public authorities, or (ii) the operations and finances of the State and such other matters, that the Corporation considers necessary to enable it to complete and publish an official statement, placement memorandum or other similar document relating to the sale or issuance of Bonds, and (B) the payments to be made by the State as provided in the Contract or any funds established under the Indenture, or information necessary to enable the Corporation to make any reports required by law or governmental regulations (including the Rule) in connection with any Bonds. (Section 4.3)

Neither the Corporation nor the State will terminate the Contract for any reason whatsoever. In addition, the Contract may not be amended, changed, modified or altered so as to adversely affect the rights of the owners of any Bonds, the payments to be made by the State as provided therein or the funds required by the Indenture without the consent of such owners or the Trustee given in accordance with the provisions of the Indenture. (Sections 4.4 and 4.5)

Events of Default by the State and Remedies

Pursuant to the Contract, if, for any reason (other than a failure by the State Legislature to appropriate moneys for such purpose), the State shall (i) fail to pay when due any of the payments provided for in the first paragraph under the caption "Payments by the State" above or (ii) fail to observe or perform any other covenant,

condition or agreement on its part to be observed or performed and such failure to observe or perform shall have continued for 60 days after written notice, specifying such failure and requesting that it be remedied, is given to the State by the Corporation, the Corporation shall, if such default has not been cured, have the right to institute any action in the nature of mandamus or take whatever action at law or in equity may appear necessary or desirable to collect the payments then due or thereafter to become due or to enforce performance and observance of any obligation, agreement or covenant of the State thereunder. (Section 5.1)

The remedies conferred upon or reserved to the Corporation in the foregoing paragraph in respect of any default described therein are not intended to be exclusive of any other available remedy or remedies and shall be in addition to every other remedy now or hereafter existing at law or in equity; provided, however, that such remedy or remedies may in no event include a termination of the Contract, nor may they include any amendment, change, modification or alteration that is referred to under the Contract. (Section 5.2)

Events of Default by the Corporation and Remedies

Pursuant to the Contract, if the Corporation shall fail to observe or perform any covenant, condition or agreement on its part to be observed or performed and such failure to observe or perform shall have continued for 60 days after written notice, specifying such failure and requesting that it be remedied, is given to the Corporation by the State, the State shall, if the default has not been cured, have the right to institute any action in the nature of mandamus or take whatever action at law or in equity may appear necessary or desirable to enforce the performance and observance of any obligation, agreement or covenant of the Corporation thereunder. (Section 6.1)

The remedies conferred upon or reserved to the State in the foregoing paragraph in respect of any default described therein are not intended to be exclusive of any other available remedy or remedies and shall be in addition to every other remedy now or hereafter existing at law or in equity; provided, however, that such remedy or remedies may in no event include a termination of the Contract or of the obligations of the State to make the payments provided for above under the caption "Payments by the State," nor may they include any amendment, change, modification or alteration of the Contract that is prohibited thereunder. (Section 6.2)

Miscellaneous

The Contract shall have a term ending on such date as there are no Bonds Outstanding under the Indenture. (Section 7.4)

Nothing in the Contract shall be construed to confer upon or to give notice to any person or entity other than the State, the Corporation, and the owners of any Bonds, the Trustee or any other trustee acting on their behalf, any right, remedy or claim under or by reason of the Contract or any provision thereof. (Section 7.8)

In accordance with the Act, neither the members of the Corporation nor any other person executing the Contract shall be subject to any personal liability or accountability by reason of the issuance or execution and delivery thereof. (Section 7.9)

BONDHOLDERS' RISKS

Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2003B Bonds as well as other information contained in this Official Statement. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2003B Bonds and does not necessarily reflect the relative importance of various risks. Potential purchasers of the Series 2003B Bonds are advised to consider the following factors, among others, and to review the other information in this Official Statement in evaluating the Series 2003B Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or liquidity of the Series 2003B 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 Global Insight Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to an estimated 407 billion cigarettes in 2002. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The Global Insight Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.81% to 284 billion cigarettes in 2023 under its Base Case Forecast (as defined herein), which represents a decline in adult per capita consumption at an average rate of 2.60% per year. These consumption declines are based on historical trends which may not be indicative of future trends, as well as other factors which may vary significantly from those assumed or forecasted by Global Insight. A decline in the overall consumption of cigarettes beyond the levels forecasted in the Global Insight Report could have a material adverse effect on the payments by PMs under the MSA and the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments 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. As a result of these types of initiatives and other measures nationwide, the overall consumption of cigarettes may decrease materially more than forecasted in the Global Insight Report and thereby have a material adverse effect on the amounts of Pledged Settlement Payment available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds. For a detailed description of the regulatory restrictions and legislative initiatives affecting the tobacco industry, see "APPENDIX F – CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY—Regulatory Issues."

Other Potential Payment Decreases under the Terms of the Master Settlement Agreement

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 aggregate amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" and APPENDIX C hereto.

The assumptions used to project Pledged Settlement Payments are based on the premise that certain adjustments will occur as set forth under the heading "SUMMARY OF PLEDGED SETTLEMENT PAYMENT METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. Actual adjustments could be materially different from what has been assumed.

Growth of NPM Market Share and other Factors. The assumptions used to project Pledged Settlement Payments and structure the Series 2003B Bonds contemplate declining consumption of cigarettes in the United

States combined with a static relative market share of 5%[*] for the NPMs. See "SUMMARY OF PLEDGED SETTLEMENT PAYMENT METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS." Should the forecasted decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Model Statutes (which are Qualifying Statutes under the MSA) and are thus exempt from the NPM Adjustment. One NPM has announced that it has developed a cigarette with virtually no nicotine. This NPM could use the product to capture market share causing a reduction in Annual Payments and Strategic Contribution Payments. In addition, if consumers used the product to quit smoking, it could reduce the size of the cigarette market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low and new cigarette manufacturers, whether SPMs or NPMs, are less likely to be subject to frequent litigation than OPMs. The Model Statute requires an NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM. The Model Statute further authorizes the NPM to obtain from a Settling State the release of the amount by which the escrow deposit in that state exceeds the state's allocable share of the total payments that the NPM would have made as a PM. Legislation is pending in several states to amend the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under a Qualifying Statute to the excess above the total payment that the NPM would have paid for its cigarettes had it been a PM. On October 15, 2003, the State enacted such legislation amending its Qualifying Statute (the "**Allocable Share Act**"). The State's Qualifying Statute, as amended by the Allocable Share Act, is referred to herein as the "**New York Qualifying Statute**". A majority of the PMs, including all four OPMs, have indicated in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Act, the Settling State's previously enacted Qualifying Statute will continue to constitute a Model Statute and a Qualifying Statute within the meaning of the MSA. To the extent that other states do not amend their Qualifying Statutes, NPMs could take advantage of the allocable share release provision by targeting sales in such states. If NPMs are able to gain market share in a number of such states as a result, the loss of market share by the PMs may result in an increase in the Volume Adjustment which could have a material adverse effect on the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds. Because the price of cigarettes is a factor affecting consumption, NPM cost advantage could continue to 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 the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds.

On November 18, 2003, six SPMs sent a letter to the National Association of Attorneys General ("**NAAG**") and the Attorneys General of the Settling States, which is intended to provide notice that such SPMs may initiate litigation or arbitration proceedings relating to two issues under the MSA. The MSA requires a party to provide at least 30 days' prior written notice to the other parties before initiating a proceeding to enforce the MSA or alleging breaches of the MSA. The first issue relates to the calculation of the NPM Adjustment, which such SPMs allege is not working as designed to ensure that SPMs are not penalized by becoming signatories to the MSA. Their allegations include that the Market Share Loss (as defined in the MSA) recorded by PricewaterhouseCoopers LLP, the independent auditor appointed under the MSA (the "**MSA Auditor**"), is significantly smaller than the Market Share Loss that actually exists and that the Model Statute has not been diligently enforced or that in states where it is diligently enforced, does not contain efficient and effective enforcement mechanisms. The second issue relates to a statute recently passed in Minnesota which requires distributors for all tobacco companies not already paying Minnesota under an existing agreement to pay approximately $3.50 per carton of cigarettes sold in Minnesota. Minnesota has a separate settlement agreement with the OPMs and is not a Settling State under the MSA. As a result of the Minnesota statute, the SPMs allege that SPMs, who are not parties to the Minnesota settlement agreement, are making payments for their sales in Minnesota twice, once to Minnesota and again to the Settling States under the MSA. The SPMs further allege that they are therefore at a competitive disadvantage. The SPMs specifically request in their letter to continue to discuss possible resolution of these issues with the other parties to

[*] The aggregate or market share of NPMs utilized in the Cash Flow Assumptions may differ materially from the market share information utilized by the MSA Auditor in calculating the NPM Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustment to Payments — *Non-Participating Manufacturers Adjustment*."

the MSA. The letter does not specify what type of relief would be sought in any litigation or arbitration proceedings.

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 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 MASTER SETTLEMENT AGREEMENT - 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 and subsequently, the Allocable Share Act. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes—New York Qualifying Statute". No provision of the MSA attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. In January 2002, Brown & Williamson Tobacco Corporation ("**B&W**") disputed the recalculation of the Annual Payments due in 2000 and 2001, claiming that the MSA Auditor relied upon inappropriate data in calculating B&W's market share and that a larger NPM Adjustment should have been applied to the 2001 payment because a majority of the Settling States were not diligently enforcing their Qualifying Statutes in 2000. In April 2002, NAAG reported in a public release 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 this time because it now 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 believes that the State is diligently enforcing the New York Qualifying Statute, and the State has pledged in the Sale Agreement, pursuant to the Act, to not fail to diligently enforce its Qualifying Statute. Under the Indenture and the Sale Agreement, the State is deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - MSA Provisions Related to Model/Qualifying Statutes" and "SUMMARIES OF CERTAIN PROVISIONS OF THE TRANSACTION DOCUMENTS - The Sale Agreement - *Pledges; Protection of Title; Non-Impairment Covenant*" herein.

The State has advised that in accordance with the terms of the MSA, certain of the Settling States and certain of the PMs are disputing prior MSA payments. The State has advised that 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, January 2002 and January 2003 and the Annual Payments which were due in April 2000, April 2001, April 2002 and April 2003, including disputes relating to potential NPM Adjustments. Negotiations between the Settling States and the PMs to resolve these disputes are ongoing. The State has advised that settlement of these disputes may include an agreement that certain PMs retain some or all of the funds that they have placed in the Disputed Payments Account and for various reasons be given an offset against the Pledged Settlement Payments to be received in 2004 in an amount that is not expected to exceed $4 million.

Should a PM be entitled to an NPM Adjustment in future years due to non-diligent enforcement of the New York Qualifying Statute by the State, the NPM Adjustment could have a material adverse effect on the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds. See "*Disputed or Recalculated Payments*" below. The structuring assumptions for the Series 2003B Bonds do not include any NPM Adjustments. See "SUMMARY OF PLEDGED SETTLEMENT PAYMENT METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

Disputed or Recalculated Payments. Miscalculations or recalculations 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. The State

has advised that in accordance with the terms of the MSA, certain of the Settling States and certain of the PMs are disputing prior MSA payments. The State has advised that 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, January 2002 and January 2003 and the Annual Payments which were due in April 2000, April 2001, April 2002 and April 2003, including disputes relating to potential NPM Adjustments. Negotiations between the Settling States and the PMs to resolve these disputes are ongoing. As stated previously, the State has advised that settlement of these disputes may include an agreement that certain PMs retain some or all of the funds that they have placed in the Disputed Payments Account and for various reasons be given an offset against the Pledged Settlement Payments to be received in 2004 in an amount that is not expected to exceed $4 million.

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 Annual Payments or Strategic Contribution Payments. Both the diversion of disputed payments to the Disputed Payments Account and the application of offsets against future payments could have a material adverse effect on the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds. The structuring assumptions for the Series 2003B Bonds do not factor in an offset for miscalculated or disputed payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT - Adjustments to Payments - *Offset for Miscalculated or Disputed Payments*" herein.

Risks Related to Enforceability or Modification of the Master Settlement Agreement and Constitutionality of the Model Statute

MSA Litigation. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various tobacco manufacturers, including the PMs, as well as against certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, some 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 monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed 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. On June 17, 2002, a New York State trial court judge entered an order on his own motion in *State of New York v. Philip Morris, Inc. et al.*, the 1997 New York lawsuit that was settled by the MSA. Citing unspecified ethical concerns relating to the 2001 arbitrators' award of attorneys' fees to New York lawyers representing the State of New York in connection with the MSA, the trial judge ordered all interested parties to show cause on July 10, 2002, why the court should not, among other possible actions, vacate and set aside the court's prior approval of the MSA. In July and August 2002, the six firms which formerly represented the State and counsel to the OPMs each filed papers with the Court arguing that the trial court judge had no basis for reviewing the fee award. On October 22, 2002, the trial court judge froze further payments on the $625 million award of attorneys' fees and found that the only issue before him was the reasonableness of the fee award. The firms, the State and the OPMs appealed and won a stay from the Appellate Division, preventing the trial court judge from proceeding with his inquiry until the appeal is resolved. Oral argument was held on May 27, 2003. The Appellate Division ruled on August 3, 2003 that the trial court judge does not have the jurisdiction to review the fee award and reversed his order appointing an independent counsel to defend his ruling on the appeal. The independent counsel has sought leave to appeal the decision to the Court of Appeals. On June 5, 2002, one SPM filed suit in Missouri alleging that it is required to make payments under the MSA only

on those cigarettes on which the SPM itself had paid the federal excise tax, and that no payments under the MSA were due on cigarettes on which the SPM's affiliate had paid federal excise taxes. To date, no such lawsuits have been successful; however, the enforcement of 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 interest in the Pledged Settlement Payments. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS—No Assurance as to the Outcome of Litigation" and "—Limited Remedies" below. For a description of certain opinions to be delivered to the Corporation by Hawkins, Delafield & Wood with respect to the MSA, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS —MSA Enforceability."

Model Statute. Under the MSA, downward adjustments are made to the Annual Payments and Strategic Contribution Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. A Settling State may mitigate the effect of this adjustment by adopting and enforcing its Qualifying Statute, as hereinafter described. The State has adopted a Qualifying Statute in the form of the Model Statute appended to the Master Settlement Agreement. 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. 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. Other cases have also challenged the Model Statute as part of an antitrust theory. Another case, *North American Trading Company and International Tobacco Partners. LLC v. "NAAG" et al.,* was filed in the United States District Court for the District of Columbia on July 25, 2001. In *North American*, the plaintiffs, importers of foreign-made cigarettes, have alleged that importers or wholesalers of foreign-made cigarettes intended for resale in the United States are not Tobacco Product Manufacturers ("**TPMs**"), 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. In September 2001, the District Court dismissed the case and the plaintiffs appealed. In November 2002, the Court of Appeals for the District of Columbia Circuit affirmed the District Court's dismissal. On July 1, 2002, *Grand River Enterprises Six Nations, Ltd. et al. v. William Pryor et al.* was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the Qualifying Statutes in 31 states and the complementary legislation in 14 states 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. Oral arguments on the defendant's motion to dismiss were heard on March 17, 2003. On September 29, 2003, the Court dismissed plaintiff's complaint in its entirety. On April 16, 2002, in *Freedom Holdings, Inc. v. Spitzer, in his official capacity as the Attorney General of the State of New York*, certain cigarette importers challenged legislation related to the Qualifying Statute and the MSA, alleging violations of the Commerce Clause, the Equal Protection Clause and antitrust statutes. The United States District Court for the Southern District of New York dismissed the action on May 14, 2002. The plaintiffs have appealed to the United States Court of Appeals for the Second Circuit. 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 of Hawkins, Delafield & Wood with respect to the Model Statute, and a more detailed discussion of the constitutional challenges to the Model Statute, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS—Model/Qualifying Statute Constitutionality."

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 MASTER SETTLEMENT AGREEMENT—Severability."

Amendments, Waivers and Termination. As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. The Corporation is not a party to the MSA; accordingly, the Corporation does not have rights to challenge any such amendment, waiver or termination. No assurance can be given that such an amendment, waiver or termination would not have a material adverse effect on the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Amendments and Waivers."

Reliance on State Enforcement. The State may not convey and has not conveyed to the Corporation 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. No assurance can be given that the State will enforce any particular provision of the MSA. Failure to do so may have a material adverse effect on the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds.

State Impairment. It is possible that the State could attempt to claim some or all of the Pledged Settlement Payments otherwise payable to the Corporation for itself or otherwise interfere with the security for the Series 2003B Bonds. Pursuant to the Act and the Sale Agreement, the State has covenanted and agreed for the benefit of the Bondholders that the State will (i) irrevocably direct, through the Attorney General, the independent auditor and the escrow agent under the MSA to transfer all Pledged Settlement Payments directly to the Trustee, (ii) enforce, at the expense of the State, its right to collect all monies due from the PMs under the MSA, (iii) diligently enforce, at the expense of the State, the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all tobacco product manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of the Attorney General, provided, however, as stated in the Sale Agreement, (a) that the remedies available to the Corporation and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (iii) shall be limited to injunctive relief, and (b) that the State shall be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) alter, limit or impair the Corporation's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested by the Act in the Corporation to fulfill the terms of its agreements with the Bondholders, or (c) in any way impair the rights and remedies of the 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 proceedings by or on behalf of the Bondholders, are fully paid and discharged (provided, that nothing in the Act or the Sale Agreement shall be construed to preclude the State's regulation of smoking and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the Qualifying Statute and the Complementary Legislation (as defined herein) in any way that would materially adversely affect the amount of any payment to, or materially adversely affect the rights of, the Corporation or the Bondholders. Notwithstanding these pledges and agreements by the State, the Attorney General may in his or her discretion enforce any and all provisions of the MSA without limitation. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" and "APPENDIX G – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — The Sale Agreement — *Pledges; Protection of Title; Non-Impairment Covenant.*"

Tobacco Industry Litigation

The tobacco industry has been the target of litigation for many years. In the United States, both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from environmental tobacco smoke, also known as "**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. Health care cost recovery cases have also been brought by governmental and non-governmental health care providers seeking, among other things, reimbursement for health care 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 health care cost recovery claims by the Settling States. Litigation has also been brought against certain PMs and/or their affiliates in foreign countries.

The financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs and/or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA, thus materially adversely affecting the amount of Pledged Settlement Payments available to the Corporation to pay

principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. For a detailed discussion of tobacco industry litigation, see "APPENDIX F- CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY – Civil Litigation."

Bankruptcy of PMs May Delay, Reduce or Eliminate Payments

Because a significant source of payment for the Series 2003B Bonds is the Pledged Settlement Payments, if one or more PMs were to become a debtor in a case under the United States Bankruptcy Code (the "**Bankruptcy Code**"), there could be delays, reductions or elimination of the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. On May 13, 2003, Alliance Tobacco Corporation, which is an SPM under the MSA, filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Kentucky (*In re Alliance Tobacco Corp*., Bankruptcy No. 03-11030). In *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris Cos., Inc.*), Philip Morris was ordered to post a $12 billion bond to secure the judgment, interest and costs in order to stay the money judgment pending the exhaustion of all appeals. Philip Morris stated that it would not be possible for it to post a bond in such an amount and, absent judicial or legislative relief, it would not be possible to stay enforcement of the $12 billion judgment against it. In an April 4, 2003 press release, a Philip Morris representative stated that there was a risk that immediate enforcement of the judgment would force a bankruptcy. Philip Morris had also indicated that it may not be able to make certain payments under the MSA, which were due on April 15, 2003. On April 14, 2003, the court ordered a modification in the bond amount, requiring Philip Morris to put up $6 billion in term notes and to pay approximately $800 million in cash into an escrow account. Philip Morris made the payments due under the MSA on April 15, 2003 in a timely manner. On August 15, 2003, the trial court reinstated its original $12 billion bond requirement and granted Philip Morris 60 days within which to post the required bond. Philip Morris has moved to stay the trial court's order while its appeal to the Illinois Supreme Court remains pending. On September 16, 2003, the Illinois Supreme Court agreed to hear Philip Morris' appeal in the *Price* case. Also on that date, the Supreme Court reinstated the reduced bond amount pending the appeal. The Illinois Supreme Court has established December 3, 2003 as the deadline for Philip Morris' appeal brief. Plaintiffs' appeal brief is due not later than 35 days following the filing deadline for Philip Morris' appeal brief, and Philip Morris' reply brief is due not later than 14 days following the filing deadline for the plaintiff's appeal brief. These deadlines may be subject to modification on motion of the parties. In light of the *Price* case and other litigation, several ratings agencies have downgraded the ratings of Philip Morris' parent, Altria Group, Inc. Certain OPMs have 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. For a detailed discussion of bonding requirements related to tobacco industry litigation, see "APPENDIX F- CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY."

In the bankruptcy of a PM, the automatic stay provisions of the Bankruptcy Code could prevent (unless approval of the bankruptcy court was obtained) any action by the State, the Corporation, the Trustee, or the Bondholders to collect the Pledged Settlement Payments or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying Pledged Settlement Payments, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of Pledged Settlement Payments. 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. Such a repudiation should be treated as a breach of the MSA by the PM.

Furthermore, certain payments previously made to the holders of the Series 2003B Bonds could be avoided as preferential payments, so that the Bondholders would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the Corporation, the Trustee and the Bondholders. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in Pledged Settlement Payments to the Corporation. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered to the Corporation by Hawkins, Delafield & Wood with respect to PM bankruptcy matters, see "LEGAL CONSIDERATIONS RELATING TO THE PLEDGED SETTLEMENT PAYMENTS."

The Obligations of the State Pursuant to the Contract

The Contract contains the agreement of the Director of the Budget on behalf of the State, subject to the making of annual appropriations therefor by the State Legislature, to make payments to the Corporation in an amount equal to the amount of the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds, as the same shall become due in the event that amounts on deposit in the Pledged Accounts are insufficient therefor. The obligation of the State to fund or to pay the amounts provided for by the Contract: (i) is subject to and dependent upon annual appropriations being made by the State Legislature for such purpose, (ii) shall not constitute a debt of the State within the meaning of any Constitutional or statutory provision, and (iii) shall be deemed executory only to the extent of moneys available to the State therefor; and no liability shall be incurred by the State beyond the moneys available for the purposes thereof. The State Legislature is not obligated to make appropriations to satisfy the State's obligations under the Contract and there can be no assurance that the State Legislature will make any such appropriations. See "SUMMARY OF THE CONTRACT" above.

Limited Resources of the Corporation

The Series 2003B Bonds are payable only from the assets of the Corporation, including Contract Payments, pledged under the Indenture and do not include the Previously Purchased and Pledged Settlement Payments or the Unsold Settlement Payments. In the event that such assets of the Corporation have been exhausted, no amounts will thereafter be available to be paid on the Series 2003B Bonds. The Series 2003B Bonds are not legal or moral obligations of the State, and no recourse may be had with respect thereto for payment of amounts owing on the Series 2003B Bonds. Investors in the Series 2003B Bonds must look solely to the assets of the Corporation pledged under the Indenture for repayment of their investment. The Corporation's only sources of funds for payments on the Series 2003B Bonds are the Pledged Revenues. Except to the extent that the proceeds of the Series 2003B Bonds are deposited in the Debt Service Reserve Account and the Debt Service Account, the proceeds of the Series 2003B Bonds will be, on the Closing Date, irrevocably dedicated to the use of the State as a portion of the consideration for its sale of the Pledged Settlement Payments under the Sale Agreement, and will not be available to pay debt service on Series 2003B Bonds. The Corporation has no taxing power and no assets are available to pay Bonds other than the assets acquired pursuant to the Sale Agreement, pledged under the Indenture and payments received under the Contract. No assets of the State are pledged to secure or will be available to pay debt service on the Series 2003B Bonds.

Limited Remedies

The Trustee is limited under the terms of the Sale Agreement to enforcing the terms of the agreement and to receiving the Pledged Settlement Payments and applying them in accordance with the Indenture. If an Event of Default occurs, the Trustee cannot sell its rights under the Sale Agreement. The Corporation is not a party to the MSA and has not made any representation or warranty that the MSA is enforceable. Remedies under the Sale Agreement do not include the repurchase by the State of the Pledged Settlement Payments under any circumstances, including unenforceability of the MSA, the Model Statute or breach of any representation or warranty. The remedies of the Series 2003B Bondholders are no greater than those afforded to the Trustee.

IRS Audit

The Internal Revenue Service (the "**IRS**") examined several outstanding tax-exempt bond issues secured by tobacco settlement revenues. The IRS closed its examinations of the three earliest tax-exempt bond issues of this type with no change in the tax-exempt status of the interest on such bonds under Section 103 of the Code. Other pending or future IRS audits of tax-exempt bonds of this type or others, however, could have an adverse effect on the market for or the market price of the Series 2003B Bonds. See "TAX MATTERS – Series 2003B Bonds – *IRS Audits*" herein.

LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2003B Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause the Pledged Settlement Payments to be reduced or eliminated. References in the discussion to various opinions of Hawkins, Delafield & Wood 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 State (and thus the Series 2003B 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 may be stayed for an extended time from enforcing any rights under the MSA 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 Pledged Settlement Payments, funds available to the Corporation 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.

Chapter 7 Bankruptcy. If a PM becomes bankrupt and does not reorganize under Chapter 11, 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, or even elimination, of payments 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 cessation of operations by the PM being liquidated under Chapter 7 of the Bankruptcy Code, the market share of such other PMs would increase.

Chapter 11 Reorganization. Should a PM become a debtor in a Chapter 11 reorganization bankruptcy case, the PM may not be authorized to make any payments owing under the MSA, or may be required to obtain bankruptcy court approval before making such payments. Legal proceedings necessary to determine whether such PM's obligations under the MSA can be paid during the pendency of the bankruptcy proceedings could be time consuming and could result in delays in, or elimination of, payments by the bankrupt PM. Examples of other risks include:

(a) 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 a contract in which performance remains due to some extent from both parties). Under the Bankruptcy Code, if the MSA is treated as an executory contract, a trustee in bankruptcy or a PM acting as a debtor-in-possession would have the right to assume or reject the MSA. However, there is no time period within which a trustee or PM in bankruptcy 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, or elimination of, payments by the bankrupt PM.

Hawkins, Delafield & Wood will render an opinion, 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 should hold that the MSA constitutes an executory contract under the Bankruptcy Code.

(b) Assumption or Rejection of MSA. Should a bankrupt PM determine to assume the MSA, it would have to cure all outstanding MSA payment defaults and provide "adequate assurance" that all future payments under the MSA will be paid in full. "Adequate assurance" is not defined in the Bankruptcy Code and is determined by the bankruptcy court. If the Bankruptcy court rules that the PM cannot provide such adequate assurance, payments under the MSA may be delayed or eliminated.

In the event a bankrupt PM determines to reject the MSA, the State (and thus the Corporation, the Trustee and the Bondholders, as collateral assignees) may then have a prepetition 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, the State (and thus the Corporation, the Trustee and the Bondholders) nevertheless may be enjoined from commencing or continuing any action against the PM to enforce 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 the State (and thus the Corporation, the 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, reductions, or elimination of, payments by the bankrupt PM. On May 13, 2003, Alliance Tobacco Corporation, which is an SPM under the MSA, filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Western District of Kentucky (*In re Alliance Tobacco Corp*., Bankruptcy No. 03-11030).

(c) Modification of MSA Obligations. If the MSA is determined not to be an "executory contract," the PM determines to reject the MSA or 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 Pledged Settlement Payments available to pay the Bondholders because under the Bankruptcy Code, the obligations of the PM under the MSA could be modified or discharged in their entirety. 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 under the MSA to the State.

MSA Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling.

Certain cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes and smokers' rights organizations have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA violates provisions of the United States Constitution, federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. Although numerous legal challenges to the MSA have been attempted, to date none has succeeded. A determination by a court that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term as described above, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. See "BONDHOLDERS' RISKS – Risks Related to Enforceability or Modification of the Master Settlement Agreement and Constitutionality of the Model Statute – *MSA Litigation."*

In rendering the opinion described below, Hawkins, Delafield & Wood considered the claims asserted in the federal and state actions specifically referenced in such opinion, which Hawkins, Delafield & Wood believe are representative of the legal theories that an opponent of the MSA would advance in an attempt to invalidate the MSA. Subject to the assumptions and qualifications set forth below, Hawkins, Delafield & Wood will render an opinion to the Corporation that under federal and State law the MSA is a valid, binding and enforceable obligation of the signatories thereto and that the MSA has been duly authorized, executed and delivered by the State, acting through its Attorney General. The opinions of Hawkins, Delafield & Wood as to the enforceability of the MSA and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, and other laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law.

In rendering their enforceability opinion with respect to the MSA, Hawkins, Delafield & Wood 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 (acting through its Attorney General), and each signatory's 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 (other

than the State acting through its Attorney General), 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/Qualifying 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 sought to enjoin the passage or enforcement, as the case may be, of the Model Statute (termed by the plaintiffs and the district court "**Qualifying Statute**"). The complaint alleged, among other things, that the passage, implementation and/or enforcement of the Model Statute would violate federal and state antitrust laws and certain provisions of the federal constitution, including the Interstate Compact Clause, the prohibition on Bills of Attainder, the Commerce Clause, the Import-Export Clause, the Supremacy Clause, the First Amendment, the Equal Protection Clause and the Due Process Clause. 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* case has been dismissed by the trial court and plaintiffs have appealed to the Fourth Circuit Court of Appeals. In January 2002, the Fourth Circuit affirmed the trial court's dismissal of the case. On October 7, 2002, the U.S. Supreme Court denied plaintiffs' petition for a writ of certiorari. On July 24, 2001 in *North American,* plaintiffs filed an action in the United States District Court for the District of Columbia alleging certain constitutional and antitrust claims and that the Model Statute was unenforceable as to importers of foreign-made cigarettes intended for resale in the United States. Plaintiffs requested an injunction to prevent the enforcement of the Model Statute as it applied to such importers. The action was dismissed on September 18, 2001, and the plaintiffs appealed. In November 2002, the Court of Appeals for the District of Columbia Circuit affirmed the District Court's dismissal. On July 1, 2002, a group of domestic, foreign and Native American cigarette manufacturers, importers and distributors filed suit in *Grand River Enterprises Six Nations Ltd. v. Pryor*, raising most of the same claims as in *PTI*, *North American* and *Star Scientific* and also alleging that the Model Statutes in 31 states and the complementary legislation in 14 states violate various provisions of federal law, including the Indian Commerce Clause of the federal Constitution. Oral arguments on the defendant's motion to dismiss were heard on March 17, 2003. On September 29, 2003, the Court dismissed plaintiff's complaint in its entirety. Plaintiff Grand River (but not the other plaintiffs) has asked the district court to reconsider its decision and has filed a notice of appeal. On April 16, 2002, in *Freedom Holdings, Inc. v. Spitzer, in his official capacity as the Attorney General of the State of New York*, certain cigarette importers challenged legislation related to the Qualifying Statute and the MSA, alleging violations of the Commerce Clause, the Equal Protection Clause and antitrust statutes. The United States District Court for the Southern District of New York dismissed the action on May 14, 2002. The plaintiffs have appealed to the United States Court of Appeals for the Second Circuit. 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 and there occurred the requisite impact on the market share of PMs under the MSA. See "BONDHOLDERS' RISKS –Risks Related to Enforceability or Modification of the Master Settlement Agreement and Constitutionality of the Model Statute – *Model Statute*" herein.

In rendering the opinion described below, Hawkins, Delafield & Wood considered the claims asserted in the above-referenced federal actions as well as other federal and state constitutional and statutory claims, which they believe are representative of the legal theories that an opponent of the Model Statute would advance in an attempt to invalidate the Model Statute. Subject to the assumptions and qualifications set forth below, Hawkins, Delafield &

Wood will render an opinion that the New York Qualifying Statute, in its present enacted form, is valid and enforceable under both federal and State law, and as such, is enforceable against the NPMs. The opinion of Hawkins, Delafield & Wood as to the enforceability of the New York Qualifying Statute is limited to the extent that 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). See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes – *New York Qualifying Statute*."

In rendering their enforceability opinion with respect to the New York Qualifying Statute, Hawkins, Delafield & Wood has relied upon a letter dated August 4, 1999, as affected by a letter dated September 27, 1999, from counsel to the OPMs confirming that the OPMs would not dispute that the State's Qualifying Statute constitutes a Model Statute under the MSA and letters from the majority of the PMs (including all four OPMs) confirming such PMs' agreement that in the event a Settling State amends its Qualifying Statute substantially in the form of the Allocable Share Act, such Qualifying Statute will remain a Qualifying Statute and a Model Statute for purposes of the MSA.

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

The opinions of Hawkins, Delafield & Wood described above expressly note that a court's decision regarding the matters upon which Hawkins, Delafield & Wood are opining would be based on such court's own analysis and interpretation of the factual evidence before it and of applicable legal principles. Thus, if a court reached a result different from that expressed in such opinions, such as that the MSA or Model Statute is void or voidable, it would not necessarily constitute reversible error. Consequently, an opinion of Hawkins, Delafield & Wood 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 Hawkins, Delafield & Wood 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, no such opinion is a guarantee, warranty or representation, but rather reflects the informed professional judgment of Hawkins, Delafield & Wood as to specific questions of law. Such opinions are not binding on any court or party to a court proceeding. The descriptions of the opinions set forth herein are summaries, do not purport to be complete and are qualified in their entirety by the opinions themselves.

Enforcement of Rights to Pledged Settlement Payments

It is possible that the State could in the future attempt to claim some or all of the Pledged Settlement Payments for itself, or otherwise interfere with the security for the Series 2003B Bonds. In that event, the Series 2003B Bondholders, the Trustee, or the Corporation, could assert claims based on contractual or constitutional rights.

Contractual Remedies. The Sale Agreement obligates the State to (i) irrevocably direct, through the Attorney General, the independent auditor and the escrow agent under the MSA to transfer all Pledged Settlement Payments directly to the Trustee, (ii) enforce, at the expense of the State, its right to collect all monies due from the PMs under the MSA, (iii) diligently enforce, at the expense of the State, the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all tobacco product manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of the Attorney General, provided, however, as stated in the Sale Agreement, (a) that the remedies available to the Corporation and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (iii) shall be limited to injunctive relief, and (b) that the State shall be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) alter, limit or impair the Corporation's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested by the Act in the Corporation to fulfill the terms of its agreements with the Bondholders, or (c) in any way impair the rights and remedies of the 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 proceedings by or on behalf of the Bondholders, are fully paid

and discharged (provided, that nothing in the Act or the Sale Agreement shall be construed to preclude the State's regulation of smoking and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the Qualifying Statute and the Complementary Legislation (as defined herein) in any way that would materially adversely affect the amount of any payment to, or materially adversely affect the rights of, the Corporation or the Bondholders. Notwithstanding these pledges and agreements by the State, the Attorney General may in his or her discretion enforce any and all provisions of the MSA without limitation. If the State violates its obligations under the above provisions of the Sale Agreement so as to impair the Corporation's right to the Pledged Settlement Payments, the Trustee, as assignee of the Corporation's rights under the Sale Agreement, could seek to compel the State to enforce its payment rights under the MSA.

Constitutional Claims. The Series 2003B Bondholders are further entitled to the benefit of the prohibitions in the United States Constitution's Contract Clause against any state's impairment of the obligation of contracts. This prohibition, although not absolute, is particularly strong when applied to a state's attempt to evade its own obligations.

Based on the U.S. Supreme Court's standard of review for Contract Clause challenges in *Energy Reserves Group, Inc. v. Kansas Power & Light Co.,* 459 U.S. 400 (1983), the State must justify the exercise of its inherent police power to safeguard the vital interests of its people before the State may alter the MSA, the Decree or the financing arrangements in a manner that would substantially impair the rights of the Series 2003B Bondholders to be paid from the Pledged Settlement Payments. However, to justify the enactment by the State of legislation that substantially impairs the contractual rights of the Series 2003B Bondholders to be paid from the Pledged Settlement Payments, the State must demonstrate a significant and legitimate public purpose, such as the remedying of a broad and general social or economic problem. In the event that the State demonstrates a significant and legitimate public purpose for such legislation, the State must also show that the impairment of the Series 2003B Bondholders' rights are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Finally, the Series 2003B Bondholders may also have constitutional claims under the Due Process Clauses of the United States and New York Constitutions.

No Assurance as to the Outcome of Litigation

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 Pledged Settlement Payments or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be predicted with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) 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 amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Bonds.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

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

General

The MSA is an industry-wide settlement of litigation between the Settling States (including the State) 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 (as previously defined, the "**SPMs**") to become parties to the MSA. The four OPMs together with 39 SPMs are referred to as the "**PMs**." The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas), that settled with the OPMs prior to the adoption of the MSA (the "**Previously-Settled States**"). According to NAAG, as of November 18, 2003, 39 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.	Liggett Group, Inc.
Lorillard Tobacco Company	Anderson Tobacco Company, LLC	Lignum-2, Inc.
Philip Morris, USA (formerly Philip Morris Incorporated)	Bekenton, S.A.	Mac Baren Tobacco Company A/S
R.J. Reynolds Tobacco Company*	Canary Islands Cigar Co.	Monte Paz (Compania Industrial de Tabacos Monte Paz, S.A.)
	Caribbean-American Tobacco Corp (CATCORP)	P.T. Djarum
	Chancellor Tobacco Company, PLC	Pacific Stanford Manufacturing Corporation
	Commonwealth Brands, Inc.	Peter Stokkebye International A/S
	Cutting Edge Enterprises, Inc.	Planta Tabak-manufaktur Gmbh & Co.
	Daughters & Ryan, Inc.	Poschl Tabak GmbH & Co. KG
	Dhanraj Imports, Inc.	Premier Manufacturing Incorporated
	Eastern Company S.A.E.	Santa Fe Natural Tobacco Company, Inc.
	House of Prince A/S	Sherman 1400 Broadway, N.Y.C. Inc.
	Imperial Tobacco Limited/ITL (USA) Limited	Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	International Tobacco Group (Las Vegas), Inc.	Top Tobacco, LP
	Japan Tobacco International U.S.A., Inc.	Vector Tobacco Inc.
	King Maker Marketing	Virginia Carolina Corporation, Inc.
	Konci G&D Management Group (USA) Inc.	Von Eicken Group
	Kretek International	Wind River Tobacco Company, LLC
	Lane Limited	VIP Tobacco USA, Ltd.
	Liberty Brands, LLC	

* On October 27, 2003, R.J. Reynolds Tobacco Holdings, Inc. and British American Tobacco p.l.c. announced the signing of a definitive agreement to combine the assets and operations of their respective U.S. tobacco businesses. R.J. Reynolds Tobacco Holdings, Inc. stated in its Form 10-Q filed with the SEC for the three-month period ending September 30, 2003, that the agreement provides for establishing a new publicly traded holding company, and that the transaction is expected to close in the first half of 2004. See Appendix F—"CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY".

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 their past, present and future affiliates, divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, tobacco-related organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing) (the "**Released Parties**") are released from claims based on past conduct, acts or omissions (including any future damages arising therefrom) in any way relating to the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, or exposure to, or research statements or warnings regarding, tobacco products; and monetary claims based on future conduct, acts or omissions in any way relating to the use of or exposure to tobacco products manufactured in the ordinary course of business, including future claims for reimbursement of health care costs.

This release is binding upon each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions. The MSA further purports 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, in each case, whether or not any of them participate in the MSA (a) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of such Settling State, as opposed solely to private or individual relief for separate and distinct injuries, or (b) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State. All such persons or entities are referred to collectively in the MSA as "**Releasing Parties**".

To the extent 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 is ineffective as to the New York 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 Released Parties and they are referred to in the MSA individually as a "**Released Party**". 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.

Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.* See "– Initial Payments," "– Annual Payments" and "–Strategic

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

Contribution Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustment to Payments" below. SPMs are not required to make Initial Payments. Thus far, the OPMs have made all the Initial Payments and Annual Payments due April 15, 2000, April 15, 2001, April 15, 2002 and April 15, 2003. The base amounts of the Annual Payments increase from $4.5 billion in 2000 to $9.0 billion in 2018, and are required to be made in perpetuity. The State's share of the Initial Payments and the Annual Payments due April 15, 2000, April 15, 2001, April 15, 2002 and April 1, 2003 were received by the State and are not pledged to the payment of the Series 2003B Bonds. See "– Payments Made to Date" below.

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 market share. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, the Initial Payments, Annual Payments and Strategic Contribution Payments are to be made to the MSA Escrow Agent, which in turn will disburse 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 $2.4 billion which was received by the Settling States in December 1999 upon Final Approval. The 2000 Initial Payment, which had a scheduled base amount of $2.472 billion, was paid in December 1999. The 2001 Initial Payment, which had a scheduled base amount of $2.546 billion, was paid in December 2000. The 2002 Initial Payment, which had a scheduled base amount of $2.623 billion, was paid in December 2001. The 2003 Initial Payment, which had a scheduled base amount of $2.701 billion, was paid in December 2002. See "– Payments Made to Date" below. Since all the Initial Payments have been received by the State, no Initial Payments are included in the Pledged Settlement Payments; however, certain adjustments to Initial Payments, if such adjustments are received on or after January 1, 2004, are included in the Pledged Settlement Payments. Finally, subsequent adjustments to the Initial Payments may impact future Annual Payments and Strategic Contribution Payments.

In the case of the up-front Initial Payment in 1998, the relative payment responsibilities of the OPMs were calculated using their respective market capitalization percentages, as specified in the MSA. Thereafter, the respective payment responsibilities are to be 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 NAAG's executive committee). The term "**cigarette**" is defined in the MSA to mean any product that contains tobacco and nicotine, is intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco.

Annual Payments

The PMs are required to make Annual Payments on each April 15 beginning on April 15, 2000 to continue in perpetuity. The PMs made the first Annual Payment due April 15, 2000, the base amount of which (before adjustments discussed below) was $4.5 billion. The PMs made the second Annual Payment due April 15, 2001, the base amount of which (before adjustments discussed below) was $5.0 billion. The PMs made the third Annual Payment due April 15, 2002, the base amount of which (before adjustments discussed below) was $6.5 billion. The PMs made the fourth Annual Payment due April 15, 2003, the base amount of which (before adjustments discussed below) was $6.5 billion. The base amount 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	2018	9,000,000,000
2009	8,139,000,000	Thereafter	9,000,000,000

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, and reduced by the Previously-Settled States Reduction, and then further adjusted by the Volume Adjustment and other adjustments described below. The SPMs are required to make Annual Payments if their market share increases above the higher of their 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 Litigating Releasing Parties Offset, and
- the Offset for Claims-Over.

Application of these adjustments resulted in a material reduction of tobacco settlement receipts from the scheduled base amounts of the Annual Payments made by the PMs in April 2000, April 2001, April 2002 and April 2003, as discussed below under the caption "– Payments Made to Date" below. The State's share of the Initial Payments, the April 2000 Annual Payment, the April 2001 Annual Payment, the April 2002 Annual Payment and the April 2003 Annual Payment are not pledged to payment of the Series 2003B Bonds and were paid directly to the State free and clear of the lien of the Indenture.

Strategic Contribution Payments

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

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

- the Inflation Adjustment,
- the Volume Adjustment,
- the Non-Settling States Reduction,

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

Adjustments to Payments

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

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

Previously-Settled States Reduction. The base amounts of the Annual Payments (as adjusted by any Inflation Adjustment or Volume Adjustment, if any) are subject to a reduction reflecting the four states (Mississippi, Florida, Texas and Minnesota) that had settled with the OPMs prior to the adoption of the MSA (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 and Strategic Contribution Payments are not subject to the Previously-Settled States Reduction.

Non-Settling States Reduction. In the event that the MSA terminates as to any Settling State, the Initial Payments, Annual Payments and Strategic Contribution 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 therefor 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 decrease is due to the effects of the MSA, an adjustment (the "**NPM Adjustment**") is applied to the Annual Payment and Strategic Contribution Payments 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 PM's 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 and Strategic Contribution Payments due from the PMs. The NPM Adjustment applies only to the Annual Payments and Strategic Contribution Payments, and does not apply at all if the number of cigarettes shipped in or to the United States in the year prior to the year in which the payment is due by all manufacturers that were PMs prior to December 7, 1998 exceeds the number of cigarettes shipped in or to the United States by all such PMs in 1997.

The NPM Adjustment is also state-specific in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces a Model Statute or Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a pro-rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute or (ii) enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces 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. See "– MSA Provisions Relating to Model/Qualifying Statutes" below. If a Model Statute is not diligently enforced, a Settling State may be subject to an NPM Adjustment. See "BONDHOLDERS' RISKS - Risks Related to Enforceability or Modification of the Master Settlement Agreement and Constitutionality of the Model Statute – *Model Statute*."

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 by such Settling State 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 or Strategic Contribution Payments made by a PM within four years of a date of actual receipt of any revenues by the MSA Escrow Agent, the MSA Auditor will recalculate the payment and make provisions for an 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 United States 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 a Disputed Payments Account pending resolution of the dispute. Failure to pay such disputed amounts into the Disputed Payments Account can result in liability for interest at the penalty rate if the disputed amount was in fact properly due and owing.

Litigating Releasing Parties Offset. If any Releasing Party initiates litigation against a PM for any of the claims released in the MSA, the PM may be entitled to an offset against such PM's payment obligation under the MSA (the "**Litigating Releasing Parties Offset**"). A defendant PM may offset dollar-for-dollar any amount paid in

settlement, stipulated judgment or litigated judgment against the amount to be collected by the applicable Settling State under the MSA only if the PM has taken all ordinary and reasonable measures to defend that action fully and only if any settlement or stipulated judgment was consented to by the state attorney general. The Litigating Releasing Parties Offset is state-specific. Any reduction in MSA payments as a result of the Litigating Releasing Parties Offset would apply only to the Settling State of the Releasing Party.

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

Subsequent Participating Manufacturers

SPMs are only obligated to make Annual Payments and Strategic Contribution Payments which are made at the same times as the Annual Payments and Strategic Contribution Payments to be made by OPMs. Annual Payments and Strategic Contribution Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)) for the year preceding the payment exceeds its "**Base Share**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. Thirteen of the current 39 SPMs signed the MSA on or before the February 22, 1999 deadline.

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first four Annual Payments and the Escrow Agent has disbursed to the State its allocable portions thereof totaling approximately $1,884,000,000 to date. These payments were not sold to the Corporation and therefor are not pledged to payment of the Series 2003B Bonds, and were paid directly to the State, free and clear of the lien of the Indenture. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA.

Payments Made to Date

	State Unadjusted Allocable Share of MSA Base Amount*	State Actual Payment*†
Up-Front Initial Payment	$157,000,000	$161,000,000
January 10, 2000 Initial Payment	161,000,000	140,000,000
January 10, 2001 Initial Payment	166,000,000	127,000,000
January 10, 2002 Initial Payment	171,000,000	127,000,000
January 10, 2003 Initial Payment	176,000,000	140,000,000
April 15, 2000 Annual Payment	294,000,000	226,000,000
April 15, 2001 Annual Payment	327,000,000	266,000,000
April 15, 2002 Annual Payment	425,000,000	358,000,000
April 15, 2003 Annual Payment	425,000,000	334,000,000
Non-Allocable Amounts Received	n/a	23,000,000

* Rounded to the nearest million.

† As reported by the State, to the best of the State's knowledge, amounts reflect the State's actual receipts after applicable adjustments or disputes.

Amounts calculated by the MSA Auditor and paid to the Settling States as Initial Payments and Annual Payments are subject to subsequent recalculation as a result of revisions or additions to the information received by the MSA Auditor. No assurance can be given as to the magnitude of any such recalculation. Any such recalculation could trigger the Offset for Miscalculated or Disputed Payments. The amounts shown in the table above under the heading "State Unadjusted Allocable Share of MSA Base Amount" are the amounts shown in the MSA, calculated for the State, without any adjustment. The amounts shown in the table above under the heading "State Actual Payments" are actual amounts received and no attempt has been made to indicate to what extent each such amount is greater or less than it would otherwise have been if it has not been adjusted to reflect the recalculation of one or more earlier payments.

"Most Favored Nation" Provisions

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

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

State-Specific Finality and Final Approval

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

"**State-Specific Finality**" means, with respect to an individual Settling State, that (i) such state has settled its pending or potential litigation against the tobacco companies with a consent decree, which decree has been approved and entered by a court within the Settling State and (ii) the time for all appeals against the consent decree has expired. State-Specific Finality for the State was achieved on February 25, 2000. As of December 12, 2000 all Settling States had achieved State Specific Finality.

"**Final Approval**" marks the approval of the MSA by the Settling States which was achieved on November 12, 1999 when at least 80% of the Settling States, both in terms of number and dollar volume entitlement to the proceeds of the MSA, reached State-Specific Finality.

Disbursement of Funds from Escrow

The MSA Auditor makes all calculations necessary to determine the amounts to be paid by each PM, as well as the amounts to be disbursed to each of the Settling States. Upon completing any particular set of disbursement calculations, the MSA Auditor must provide copies of the calculations to all parties to the MSA, who shall each have 10 days within which to question or challenge 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. To the extent that a challenge results in PM payment obligations being less than amounts paid and distributed, the difference can be set off and thus reduce future payments by PMs.

Disbursement of the funds by the MSA Escrow Agent from the escrow accounts shall occur within 10 business days of receipt of the particular funds. The MSA Escrow Agent will disburse the funds due to, or as directed by, each Settling State in accordance with instructions received from that state.

Remedies Upon the Failure of a PM to Make a Payment

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

Termination of Agreement

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

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

actions dismissed pursuant to the MSA. The parties will return to the positions they were in prior to the execution of the MSA.

Severability

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

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

General. The MSA sets forth the schedule and calculation of payments to be made by OPMs to the Settling States. As described above, the Annual Payments and Strategic Contribution 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 participating in the MSA.

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

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

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

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

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

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

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

New York Qualifying Statute. Both houses of the New York State Legislature passed a Qualifying Statute, codified as Article 13-G of the Public Health Law, which was signed by the Governor on September 28, 1999 and became effective 60 days after such date. By letter dated August 4, 1999, as affected by a letter dated September 27, 1999, counsel to the OPMs confirmed that the OPMs will not dispute that the New York State Qualifying Statute constitutes a Model Statute under the MSA. In October 2003, the State enacted the Allocable Share Act to amend Article 13-G by eliminating the provision authorizing an NPM to obtain the release of the amount by which its annual escrow deposit exceeds 12.7620310% of the total payments that the NPM would have made as a PM for that year. Under the Allocable Share Act, an NPM is entitled to the release of its escrow deposit only to the extent that it exceeds the total amount that the NPM would have paid for its cigarettes as a PM. A majority of the PMs, including all four OPMs, have indicated in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Act, the Settling State's previously enacted Qualifying Statute will continue to constitute a Model Statute and a Qualifying Statute within the meaning of the MSA.

Complementary Legislation

Pursuant to the provisions of Sections 480-b, 481(i)(c) and 1846(a-1) of the State Tax Law (collectively, the "**Complementary Legislation**"), tobacco product manufacturers whose cigarettes are sold in the State are required to annually certify that either (i) they are PMs that have complied with requirements of the MSA or (ii) they have complied with the Public Health Law requirement to deposit money in a qualified escrow fund. No cigarette tax stamps may be affixed to the cigarettes of any tobacco product manufacturers that do not make such certification. In addition to any other penalties that may be imposed by law, a civil penalty can be imposed on any tobacco product manufacturer who files a false certification or any cigarette tax agent who affixes a cigarette tax stamp in violation of the Complementary Legislation, and such cigarettes can be seized and are subject to forfeiture.

NEW YORK CONSENT DECREE

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

Introduction and Overview

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

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

Pursuant to the allocation percentages set forth in the MSA, the State is entitled to 12.7620310% of the total amount of Annual Payments (prior to adjustments). In addition, pursuant to the procedures agreed to in the MSA, the State is entitled to receive 5.4873402% of the total amount of Strategic Contribution Payments (prior to adjustments). The allocation of the Annual Payments to be made pursuant to the MSA to the State, the City and the Counties is set forth in the Consent Decree, which provides that the State is to receive 51.176% of the State's share of the Annual Payments (which represents 6.5310970% of the Annual Payments payable under the MSA) and 100% of the Strategic Contribution Payments. The "**State's Share**" of such payments consists of the Strategic Contribution Payments and Annual Payments so allocated to the State and received by the State on or after January 1, 2004.

Rights to Enforce Provisions of the Consent Decree

In addition to allocating the Annual Payments among the State, the City and the Counties, the Consent Decree defines who may enforce the provisions of the Consent Decree. The Consent 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 Consent Decree does provide, however, that the City or the Counties may enforce their payment rights against the State, the City or the Counties.

Release and Dismissal of Claims

The Consent Decree further provides that, effective upon the occurrence of State-Specific Finality in the State, the City and the Counties unconditionally will release and discharge all released claims against all Released

Parties to the same extent that the State released its claims pursuant to the MSA. The City and Counties have agreed 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.

SUMMARY OF THE GLOBAL INSIGHT REPORT

The following is a brief summary of the Global Insight Report, a copy of which is attached hereto as APPENDIX E. This summary does not purport to be complete and the Global Insight Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Global Insight 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

Global Insight (USA), Inc. ("**Global Insight**"), formerly known as DRI•WEFA Inc. and as WEFA, Inc., has prepared a report, dated November 6, 2003 (the "**Global Insight Report**") for the Corporation on the consumption of cigarettes in the United States from 2002 through 2023 entitled, "*A Forecast of U. S. Cigarette Consumption (2002-2023) for the Tobacco Settlement Financing Corporation (State of New York).*" Global Insight is an internationally recognized econometric and consulting firm of over 200 economists in 16 offices worldwide. Global Insight Inc. is a privately held company which is a provider of financial, economic and market research information. The Global Insight 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.

Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2001. The model was constructed by Global Insight after considering 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 determining which variables were effective in building this cigarette consumption model (including real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences), Global Insight employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capital 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.

The Global Insight model was then used to project total United States cigarette consumption from 2002 thought 2023. Global Insight projects that after 2003 the rate of decline in total cigarette consumption will moderate and average less than 2% per year. From 2001 through 2023 Global Insight projects that the average annual rate of decline will be 1.81% and on a per capita basis, Global Insight projects consumption to decline at an average rate of 2.60% per year. Global Insight's analysis indicates that total consumption in 2023 will be 284 billion cigarettes (approximately 14 billion packs), a 33% decline from the 2001 level (the "**Base Case Forecast**"). The Global Insight Report states that Global Insight 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:

Global Insight Base Case Forecast of U.S. Cigarette Consumption

Year	Cigarettes (billions)	Year	Cigarettes (billions)
2002	406.50	2013	335.90
2003	393.62	2014	329.95
2004	386.96	2015	324.71
2005	381.69	2016	319.48
2006	376.09	2017	314.11
2007	370.57	2018	308.83
2008	365.00	2019	303.49
2009	358.90	2020	298.55
2010	353.27	2021	293.59
2011	347.65	2022	288.83
2012	341.81	2023	284.10

The Global Insight Report also presents alternative forecasts that project higher and lower paths of cigarette consumption. Under these scenarios, which Global Insight considers to be less likely, Global Insight forecasts that by 2023 US cigarette consumption could be as low as 268 billion and as high as 295 billion cigarettes. In addition, the Global Insight Report also presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption. For a discussion of the projections and the assumptions on which they are based see "APPENDIX E- GLOBAL INSIGHT REPORT."

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 the current study. By the final year of the prior forecast, 2042, the current forecast is 7% greater than the 1999 forecast, 210 billion vs. 196 billion. In the 1999 study the projected level of 1999 consumption was 432 billion; the estimated number from the USDA was slightly higher, 435 billion.

Global Insight incorporated this and other new data in 2000. At that time Global Insight realized that price increases had been greater than anticipated in their 1999 study. Global Insight increased their retail price assumption for 2000 from $3.03 to $3.39, and correspondingly decreased their 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 their forecast had assumed. Increased consumption due to lower than anticipated prices explains most of the revision to their 2000 and 2001 consumption forecasts.

The current forecast also differs somewhat from one presented to other issuers in 2002 and earlier in 2003. The recent revisions in this forecast are due to three factors. First, a larger number than originally anticipated of state excise tax increases went into effect in 2002. Global Insight has moderated their forecast to take them fully into account. Second, based on shipment reports from manufacturers and collection reports from the BATF, the historical level of shipments for 2001 and 2002 is estimated to be higher. Third, in light of the reported shipment declines in late 2002 and early 2003, Global Insight has increased their projected rate of consumption decline in 2003.

SUMMARY OF PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to calculate a forecast of Pledged Settlement Payments to be received by the Corporation (the "**Collection Methodology and Assumptions**"), as well as the methodology and assumptions used to structure the schedule of principal and Sinking Fund Installments (the "**Structuring Assumptions**"). The assumptions are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed here. If actual results are different from those assumed, it could have a material effect on the forecast of Pledged Settlement Payments.

Collection Methodology and Assumptions

In calculating a forecast of Pledged Settlement Payments to be received by the Corporation, the forecast of cigarette consumption in the United States developed by Global Insight and described as the Base Case Forecast was applied to calculate Annual Payments and Strategic Contribution Payments to be made by the PMs pursuant to the MSA. The calculation of payments required to be made was 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 Collection forecast period at 90% for the OPMs, 5% for the SPMs and 5% for the NPMs.† It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2003B Bonds. Additionally, it was assumed that the proposed merger of Reynolds Tobacco and B&W will not affect projected consumption.

In applying the consumption forecast from the Global Insight Report, it was assumed that United States consumption, which was forecasted by Global Insight, was equal to the number of cigarettes shipped in and to the United States, the District of Columbia and Puerto Rico, which is the number that is applied to determine the Volume Adjustment. The Global Insight 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. Global Insight's Base Case Forecast for United States cigarette consumption is set forth herein under "SUMMARY OF THE GLOBAL INSIGHT REPORT." See APPENDIX E for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Report.

Annual Payments

In accordance with the Collection Methodology and Assumptions, 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, using a rate of 3.4% for 2000. Thereafter, the inflation adjustment was assumed to be the minimum provided in the MSA, at a rate of 3% per year, compounded annually, for the rest of the Collection forecast period.

Volume Adjustment. Next, the annual amounts calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the Global Insight Base Case Forecast for United States cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was

† The aggregate market share information utilized in the bond structuring assumptions may differ materially from the market share information utilized by the MSA Auditor in calculating adjustments to Initial Payments, Annual Payments and Strategic Contribution Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments."

assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously-Settled States Reduction. Next, the annual 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 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 states that remain parties to the MSA. Thus, the Collection Methodology and Assumptions include an assumption that the State will remain a party to the MSA.

NPM Adjustment. The NPM Adjustment will not apply to the Annual Payments payable to any state that enacts and enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The Collection Methodology and Assumptions include an assumption that the State will enforce a Qualifying Statute that is not held to be unenforceable. For a discussion of the State Model Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model Statute/Qualifying Statutes – *State Model Statute*."

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

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

Offset for Claims-Over. The Collection Methodology and Assumptions include an assumption that the Offset for Claims-Over will not apply.

Subsequent Participating Manufacturers. The Collection Methodology and Assumptions assume that the relative market share of the SPMs remains constant at 5%. Because the 5% market share is greater than 3.125% (125% of 2.5%, the SPMs' estimated 1997 market share), Collection Methodology and Assumptions assume that the SPMs will be required to make Annual Payments in each year.

State's Share. The amount of Annual Payments payable to the State pursuant to the Consent Decree, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction for each year was multiplied by the State's Share (6.5310970%) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the State. The Consent Decree allocates 51.176% of the Annual Payments (which represents 6.5310970% of the Annual Payments payable under the MSA) to the State and the remaining 48.824% of the Annual Payments to the City of New York and all other counties located within the State. Pledged Settlement Payments equal $22,951,241 in 2004 and fifty percent (50%) of the State's Share of the Annual Payments in each year thereafter.

The following table shows the projection of Annual Payments to be received by the Trustee through the year 2023, calculated in accordance with the Collection Methodology and Assumptions.

Projection of Annual Payments to be Received by Trustee

Date	Global Insight Base Case Consumption Forecast	OPM Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	State's Share	Annual Payments	Pledged Settlement Payments Allocation	Total OPM Payments to Trustee	SPM Payments to Trustee	Total Annual Payments to Trustee
2004	386,960,000,000	348,264,000,000	$8,000,000,000	$1,310,208,876	$ (2,328,649,113)	$ (869,204,191)	$6,112,355,573	6.5310970%	$399,203,871	5.6156%	$22,417,789	$ 533,452	$ 22,951,241
2005	381,690,000,000	343,521,000,000	8,000,000,000	1,589,515,143	(2,516,934,429)	(880,536,299)	6,192,044,415	6.5310970	404,408,427	50.0000	202,204,214	4,811,637	207,015,850
2006	376,090,000,000	338,481,000,000	8,000,000,000	1,877,200,597	(2,688,963,080)	(894,935,571)	6,293,301,946	6.5310970	411,021,655	50.0000	205,510,827	4,890,320	210,401,148
2007	370,570,000,000	333,513,000,000	8,000,000,000	2,173,516,615	(2,875,273,514)	(908,631,266)	6,389,611,834	6.5310970	417,311,747	50.0000	208,655,873	4,965,160	213,621,033
2008	365,000,000,000	328,500,000,000	8,139,000,000	2,521,789,910	(3,122,108,261)	(922,536,789)	6,616,144,860	6.5310970	432,106,838	50.0000	216, 053,419	5,128,736	221,182,155
2009	358,900,000,000	323,010,000,000	8,139,000,000	2,841,613,607	(3,329,183,091)	(936,334,291)	6,715,096,225	6.5310970	438,569,448	50.0000	219,284,724	5,205,441	224,490,165
2010	353,270,000,000	317,943,000,000	8,139,000,000	3,171,032,015	(3,556,987,664)	(948,769,158)	6,804,275,194	6.5310970	444,393,813	50.0000	222,196,907	5,274,571	227,471,478
2011	347,650,000,000	312,885,000,000	8,139,000,000	3,510,332,976	(3,785,311,710)	(962,349,820)	6,901,671,447	6.5310970	450,754,857	50.0000	225,377,428	5,350,071	230,727,500
2012	341,810,000,000	307,629,000,000	8,139,000,000	3,859,812,965	(4,023,911,418)	(975,918,656)	6,998,982,891	6.5310970	457,110,362	50.0000	228,555,181	5,425,506	233,980,687
2013	335,900,000,000	302,310,000,000	8,139,000,000	4,219,777,354	(4,278,461,991)	(988,818,541)	7,091,496,822	6.5310970	463,152,536	50.0000	231,576,268	5,497,221	237,073,489
2014	329,950,000,000	296,955,000,000	8,139,000,000	4,590,540,675	(4,546,316,369)	(1,001,411,895)	7,181,812,412	6.5310970	469,051,135	50.0000	234,525,567	5,567,232	240,092,800
2015	324,710,000,000	292,239,000,000	8,139,000,000	4,972,426,895	(4,827,363,884)	(1,013,751,906)	7,270,311,105	6.5310970	474,831,070	50.0000	237,415,535	5,635,835	243,051,371
2016	319,480,000,000	287,532,000,000	8,139,000,000	5,365,769,702	(5,103,403,000)	(1,028,106,799)	7,373,259,903	6.5310970	481,554,756	50.0000	240,777,378	5,715,640	246,493,018
2017	314,110,000,000	282,699,000,000	8,139,000,000	5,770,912,793	(5,391,401,907)	(1,042,442,173)	7,476,068,713	6.5310970	488,269,299	50.0000	244,134,650	5,795,336	249,929,985
2018	308,830,000,000	277,947,000,000	9,000,000,000	6,842,842,068	(6,298,349,083)	(1,056,257,227)	8,488,235,758	6.5310970	554,374,911	50.0000	277,18 7,455	6,493,334	283,680,790
2019	303,490,000,000	273,141,000,000	9,000,000,000	7,318,127,330	(6,647,063,894)	(1,070,264,357)	8,600,799,079	6.5310970	561,726,531	50.0000	280,863,265	6,579,443	287,442,708
2020	298,550,000,000	268,695,000,000	9,000,000,000	7,807,671,150	(7,012,903,049)	(1,083,954,340)	8,710,813,761	6.5310970	568,911,696	50.0000	284,455,848	6,663,602	291,119,450
2021	293,590,000,000	264,231,000,000	9,000,000,000	8,311,901,284	(7,381,869,741)	(1,098,923,494)	8,831,108,049	6.5310970	576,768,233	50.0000	288,384,116	6,755,625	295,139,741
2022	288,830,000,000	259,947,000,000	9,000,000,000	8,831,258,323	(7,767,324,106)	(1,113,742,057)	8,950,192,160	6.5310970	584,545,732	50.0000	292,272,866	6,846,722	299,119,588
2023	284,100,000,000	255,690,000,000	9,000,000,000	9,366,196,073	(8,162,450,832)	(1,129,214,477)	9,074,530,764	6.5310970	592,666,406	50.0000	296,333,203	6,941,839	303,275,042

Strategic Contribution Payments

In accordance with the Collection Methodology and Assumptions, the amount of Strategic Contribution Payments to be made by the PMs was calculated by applying the adjustments applicable to the Strategic Contribution Payments in the amounts, set out in the MSA, as follows:

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Strategic Contribution Payments set forth in the MSA, using a rate of 3.4% for 2000. Thereafter, the Inflation Adjustment was assumed to be the minimum provided in the MSA, 3% per year, compounded annually, for the entire Collection forecast period.

Volume Adjustment. Next, the Strategic Contribution Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the Global Insight Base Case Forecast for United States cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

NPM Adjustment. The NPM Adjustment will not apply to the Strategic Contribution Payments payable to any state that enacts and enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The Collection Methodology and Assumptions include an assumption that the State will enforce a Qualifying Statute that it is not held to be unenforceable. For a discussion of the State Model Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model Statute/Qualifying Statutes – *State Model Statute.*"

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

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

Offset for Claims-Over. The Collection Methodology and Assumptions include an assumption that the Offset for Claims-Over will not apply.

Non-Settling States Reduction. For the reasons described above under "– Annual Payments," the Non-Settling States Reduction was not applied to the Strategic Contribution Payments.

Subsequent Participating Manufacturers. The Collection Methodology and Assumptions assume that the relative market share of the SPMs remains constant at 5%. Because the 5% market share is greater than 3.125% (125% of 2.5%, the SPM's estimated 1997 market share), Collection Methodology and Assumptions assume that the SPMs will be required to make Strategic Contribution Payments in each year.

State's Share. The amount of Strategic Contribution Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction for each year was multiplied by the State's Share (5.4873402%) in order to determine the amount of Strategic Contribution Payments to be made by the PMs in each year to be allocated to the State. The Consent Decree allocates 100% of the Strategic Contribution Payments (which represents 5.4873402% of the Strategic Contribution Payments under the MSA) to the State and 0% of the Strategic Contribution Payments to the City of New York and all other counties located within the State. Pledged Settlement Payments equal $22,951,241 in 2004 and fifty percent (50%) of the State's Share of the Strategic Contribution Payments in each year thereafter.

The following table shows the projection of Strategic Contribution Payments and total payments (including Annual Payments and Initial Payments) to be received by the Trustee through the year 2023, calculated in accordance with the Collection Methodology and Assumptions.

Projection of Strategic Contribution Fund and Total Payments to be Received by Trustee

			Strategic Contribution Payments								Total Payments			
Date	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Strategic Contribution Payments	Inflation Adjustment	Volume Adjustment	Subtotal	State's Share	Strategic Contribution Payments to New York	Pledged Settlement Payments Allocation	Strategic Contribution Payments to Trustee	SPM Payments to Trustee	Total Annual Payments to Trustee	Total Strategic Contribution Payments to Trustee	Total Payments to Trustee
2004	$386,960,000,000	$348,264,000,000	–	–	–	–	5.4873402%	–	5.6156%	–	–	$ 22,951,241	–	$ 22,951,241
2005	381,690,000,000	343,521,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	207,015,850	–	207,015,850
2006	376,090,000,000	338,481,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	210,401,148	–	210,401,148
2007	370,570,000,000	333,513,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	213,621,033	–	213,621,033
2008	365,000,000,000	328,500,000,000	$861,000,000	$266,772,467	$(330,278,316)	$797,494,152	5.4873402	$43,761,217	50.0000	$21,880,609	$455,846	221,182,155	$22,336,455	243,518,609
2009	358,900,000,000	323,010,000,000	861,000,000	300,605,641	(352,184,131)	809,421,511	5.4873402	44,415,712	50.0000	22,207,856	462,664	224,490,165	22,670,520	247,160,685
2010	353,270,000,000	317,943,000,000	861,000,000	335,453,811	(376,282,882)	820,170,928	5.4873402	45,005,569	50.0000	22,502,785	468,808	227,471,478	22,971,593	250,443,070
2011	347,650,000,000	312,885,000,000	861,000,000	371,347,425	(400,436,587)	831,910,838	5.4873402	45,649,778	50.0000	22,824,889	475,519	230,727,500	23,300,407	254,027,907
2012	341,810,000,000	307,629,000,000	861,000,000	408,317,848	(425,677,323)	843,640,525	5.4873402	46,293,426	50.0000	23,146,713	482,223	233,980,687	23,628,936	257,609,623
2013	335,900,000,000	302,310,000,000	861,000,000	446,397,383	(452,605,452)	854,791,931	5.4873402	46,905,341	50.0000	23,452,671	488,597	237,073,489	23,941,268	261,014,757
2014	329,950,000,000	296,955,000,000	861,000,000	485,619,305	(480,940,950)	865,678,355	5.4873402	47,502,716	50.0000	23,751,358	494,820	240,092,800	24,246,178	264,338,978
2015	324,710,000,000	292,239,000,000	861,000,000	526,017,884	(510,672,110)	876,345,774	5.4873402	48,088,074	50.0000	24,044,037	500,917	243,051,371	24,544,954	267,596,325
2016	319,480,000,000	287,532,000,000	861,000,000	567,628,420	(539,873,447)	888,754,974	5.4873402	48,769,009	50.0000	24,384,504	508,011	246,493,018	24,892,515	271,385,533
2017	314,110,000,000	282,699,000,000	861,000,000	610,487,273	(570,339,973)	901,147,300	5.4873402	49,449,018	50.0000	24,724,509	515,094	249,929,985	25,239,603	275,169,588
2018	308,830,000,000	277,947,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	283,680,790	–	283,680,790
2019	303,490,000,000	273,141,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	287,442,708	–	287,442,708
2020	298,550,000,000	268,695,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	291,119,450	–	291,119,450
2021	293,590,000,000	264,231,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	295,139,741	–	295,139,741
2022	288,830,000,000	259,947,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	299,119,588	–	299,119,588
2023	284,100,000,000	255,690,000,000	–	–	–	–	5.4873402	–	50.0000	–	–	303,275,042	–	303,275,042

Interest Earnings

The Collection Methodology and Assumptions assume that the Trustee will receive ten days after April 15 the Corporation's share of the Annual Payments owed by the PMs in 2005 and each year thereafter. It is further assumed the Trustee will receive ten days after April 15 the Corporation's share of the Strategic Contribution Payments owed by the PMs in the years 2008 through 2017. Interest is assumed to be earned on the Annual Payments and Strategic Contribution Payments received by the Trustee at the rate of 1.5% per annum until the next Distribution Date. No interest earnings have been assumed on the Annual Payments and Strategic Contribution Payments prior to the time they are received by the Trustee.

Interest is assumed to be earned on amounts on deposit in the Debt Service Reserve Account at the rate of 4.168% per annum. Moneys deposited in the Debt Service Reserve Account are expected to be invested in a guaranteed investment contract.

Structuring Assumptions

General

The Structuring Assumptions for the Series 2003B Bonds and Global Insight Base Case Forecast were applied to the projections of Pledged Settlement Payments described above. **The Global Insight Report also contains several alternative forecasts of cigarette consumption. See "SUMMARY OF THE GLOBAL INSIGHT REPORT" and APPENDIX E.**

The Structuring Assumptions are described below:

Issue Size. The objective in issuing the Series 2003B Bonds is to receive net proceeds in an amount of $1,998,541,496 to make funds available to the State.

Debt Service Reserve Account. The Debt Service Reserve Account was established for the Series 2003B Bonds with an initial deposit of $221,582,343.75. The Debt Service Reserve Account must be maintained, to the extent of available funds, at $221,582,343.75.

Debt Service Coverage Ratios. The debt service coverage ratios were structured to produce average coverage levels of Pledged Settlement Payments to estimated debt service on the Series 2003B Bonds of approximately 1.40x. For purposes of calculating the debt service coverage ratio, Pledged Settlement Payments were calculated based upon the Global Insight Base Case Forecast and interest on the Auction Rate Bonds was assumed to be an interest rate of 3.25% per annum.

Operating Expense Assumptions. Operating expenses of the Corporation have been assumed at $512,000 upon delivery of the Series 2003B Bonds and then at the Operating Cap of $500,000 inflated at 3% per year starting in 2004. No arbitrage rebate expense was assumed since it has been assumed that the yield on the Corporation investments will not exceed the yield on the Series 2003B Bonds. No Junior Payments have been assumed.

Issuance Date. The Series 2003B Bonds were assumed to be issued on December 2, 2003.

Interest Rates. The Fixed Rate Bonds were assumed to bear interest at the rates set forth on page (i) hereof and the Auction Rate Bonds were assumed to bear interest at a rate of 3.25% per annum.

Principal Amortization. Principal amortization for the Series 2003B Bonds was structured to repay the Series 2003B Bonds within 20 years from the date of issuance thereof.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2003B Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions and Structuring 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 Collection Methodology and Assumptions or Structuring Assumptions, the amount of Pledged Settlement Payments available to the Corporation to pay the principal and Sinking Fund Installments of and interest on the Series 2003B Bonds and the amount of Surplus Pledged Revenues to pay the redemption price or purchase price of the Series 2003B Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.

CONTINUING DISCLOSURE AGREEMENTS

General

To the extent that Rule 15c2-12 (the **"Rule"**) of 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 2003B Bonds, that the Corporation and the State will make such covenants, each of the Corporation and the State (each an "**Obligated Party**") will enter into an undertaking (each an "**Undertaking**") with the Trustee pursuant to which the Obligated Party will covenant for the sole benefit of the Holders of the Bonds to provide the Corporation Annual Information or the State Annual Information, as applicable, to each nationally recognized municipal securities information repository (each a "**NRMSIR**") and to any State information depository (the "**SID**"). No SID was in existence as of the date of the Undertakings.

Corporation Annual Information shall mean (A) the audited financial statements, if any, of the Corporation, prepared in accordance with generally accepted accounting principles in effect from time to time, (B) financial information or operating data with respect to the most recent Fiscal Year, of the types included in this Official Statement under "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE"; together with (C) such narrative explanation as may be necessary to avoid misunderstanding and to assist the reader in understanding the presentation of financial information and operating data and in judging the financial condition of the Corporation and (D) any additional information pursuant to a supplement to the Corporation Undertaking. Corporation Annual Information shall not include any updated projection of Pledged Settlement Payments.

Listed Event shall mean any of the following with respect to the Series 2003B Bonds:

(A) principal and interest payment delinquencies;

(B) non-payment related defaults;

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

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

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

(F) adverse tax opinions or events affecting the tax-exempt status of the Series 2003B Bonds;

(G) modifications to rights of holders of the Series 2003B Bonds;

(H) Series 2003B Bond calls and purchases of Series 2003B Bonds by the Corporation;

(I) defeasances;

(J) release, substitution, or sale of property securing repayment of the Series 2003B Bonds; and

(K) rating changes.

MSRB shall mean the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934.

State Annual Information shall mean financial information and operating data of the type included in the Annual Information Statement of the State set forth in APPENDIX B hereto, under the headings or sub-headings "Prior Fiscal Years," "Debt and Other Financing Activities," "State Government Employment," "State Retirement Systems," and "Authorities and Localities," including, more specifically, information consisting of (i) *for prior fiscal years*, an analysis of cash-basis results for the State's three most recent fiscal years, and a presentation of the State's results in accordance with GAAP for at least the two most recent fiscal years for which that information is currently available; (ii) *for debt and other financing activities*, a description of the types of financings the State is authorized to undertake, a presentation of the outstanding debt issued by the State and certain public authorities, as well as information concerning debt service requirements on that debt; (iii) *for authorities and localities*, information on certain public authorities and local entities whose financial status may have a material impact on the financial status of the State; and (iv) *material information regarding State government employment and retirement systems*; together with (v) such narrative explanation as may be necessary to avoid misunderstanding and to assist the reader in understanding the presentation of financial information and operating data and in judging the financial condition of the State.

Corporation Undertaking

Obligations of the Corporation. The Corporation shall provide, by no later than 180 days after the end of each fiscal year ending on or after January 1, 2004, (a) the Corporation Annual Information with respect to such fiscal year to each NRMSIR and the SID, and copies of such Corporation Annual Information to the Trustee and (b) notice of any change in its fiscal year or any failure by it to provide the Corporation Annual Information to each NRMSIR and the SID to (i) either the MSRB or each NRMSIR, and (ii) the SID. In addition, the Corporation shall provide, in a timely manner, to (i) either the MSRB or each NRMSIR, and (ii) the SID, notice of any of the Listed Events with respect to any outstanding Bonds, if material.

The Corporation shall, for each Distribution Date, cause to be provided to each NRMSIR and the SID information as to the aggregate principal amount that has been applied to the defeasance, purchase or optional redemption of the subject Bonds of each Series, pursuant to the Indenture, during the period ending on such Distribution Date and commencing on the day after the preceding Distribution Date.

Enforcement. The obligation of the Corporation to comply with the provisions of the Corporation Undertaking is enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data and notices, by any Beneficial Owner of outstanding Bonds, or by the Trustee on behalf of the Holders of outstanding Bonds, or (ii), in the case of challenges to the adequacy of the financial statements, financial information and operating data so provided, by the Trustee on behalf of the Holders of outstanding Bonds or by any Beneficial Owner. A Beneficial Owner may not take any enforcement action pursuant to clause (ii) without the consent of the Holders of not less than 25% in aggregate principal amount of the Bonds at the time outstanding. The Trustee shall not be required to take any enforcement action *except* at the direction of the Holders of not less than 25% in aggregate principal amount of the Bonds at the time outstanding who shall have provided the Trustee with adequate security and indemnity.

The Beneficial Owners', the Holders', and the Trustee's right to enforce the provisions of the Corporation Undertaking is limited to a right, by action in mandamus or for specific performance, to compel performance of the Corporation's obligations under the Corporation Undertaking. Any failure by the Corporation or the Trustee to perform in accordance with the terms of the Corporation Undertaking will not constitute a default or any Event of Default under the Indenture, and the rights and remedies provided by the Indenture upon the occurrence of a default or an Event of Default shall not apply to any such failure.

Amendments. The Corporation Undertaking may be amended, by written agreement of the parties, and any provision thereof may be waived, without the consent of the Holders or Beneficial Owners, except to the extent required by clause 4(ii) below, if all of the following conditions are satisfied: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Corporation or the type of business conducted thereby, (2) the Corporation Undertaking as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Bonds affected by such amendment or waiver, after taking into account any amendments or

interpretations of the Rule, as well as any change in circumstances, (3) the Corporation shall have delivered to the Trustee an opinion of Bond Counsel, addressed to the Corporation and the Trustee, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Corporation (such as the Trustee or bond counsel), acceptable to the Corporation and the Trustee, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the Holders consent to the amendment or waiver of the Corporation Undertaking pursuant to the same procedures as are required for amendments to the Indenture with consent of Holders, and (5) the Corporation shall have delivered copies of such amendment or waiver to the SID and to either each NRMSIR or the MSRB.

In addition, the Corporation and the Trustee may amend the Corporation Undertaking, and any provision thereof may be waived, if the Trustee shall have received an opinion of Bond Counsel, addressed to the Corporation and the Trustee, to the effect that the adoption and the terms of such amendment or waiver would not, in and of themselves, cause the undertakings herein to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Termination. The Corporation's and the Trustee's obligations under the Corporation Undertaking shall terminate upon the legal defeasance pursuant to the Indenture, prior redemption, or payment in full of all of the Bonds. The Corporation shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Corporation Undertaking, or any provision thereof, shall be null and void to the extent set forth in the opinion of Bond Counsel described in clause (1) in the event that the Corporation (1) delivers to the Trustee an opinion of Bond Counsel, addressed to the Corporation and the Trustee, to the effect that those portions of the Rule which require the provisions of the Corporation Undertaking, or any of such provisions, do not or no longer apply to any or all of the Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as shall be specified in such opinion, and (2) delivers notice to such effect to the SID and to either each NRMSIR or the MSRB.

State Undertaking

Obligations of the State. The State shall provide, by no later than 120 days after the end of each fiscal year, commencing with the fiscal year ending March 31, 2004 to each NRMSIR and to the SID (a) the State Annual Information with respect to such fiscal year and (b) audited financial statements of the State for such fiscal year, when available. In addition, the State shall provide, in timely manner, to (i) either the MSRB or each NRMSIR, and (ii) the SID, notice of any of the Listed Events with respect to any outstanding Series 2003B Bonds, if material.

Enforcement. The sole and exclusive remedy for breach of the State Undertaking is an action to compel specific performance of the obligations of the State. No person or entity shall be entitled to recover any monetary damages under any circumstances. The State may be compelled to comply with its obligations under the State Undertaking (i) in the case of enforcement of its obligations to provide information required thereunder, by any Holder of Outstanding Bonds or by the Trustee on behalf of the Holders of Outstanding Bonds or (ii) in the case of challenges to the adequacy of the information provided, by the Trustee on behalf of the Holders of Outstanding Bonds; provided, however, that the Trustee shall not be required to take any enforcement action except at the direction of the Holders of not less than 25% in aggregate principal amount of Bonds at the time Outstanding. Failure by the State to perform its obligations under the State Undertaking shall not constitute an Event of Default under the Indenture or any other agreement executed and delivered in connection with the issuance of the Bonds.

Amendments. Without the consent of any Holders of Bonds, the State at any time and from time to time may amend the State Undertaking for any of the following purposes: (i) to comply with or conform to any changes in Rule 15c2-12 or any formal authoritative interpretations thereof by the Securities and Exchange Commission or its staff (whether required or optional), which are applicable to the State Undertaking; (ii) to add or change a dissemination agent for the information required to be provided thereby and to make any necessary or desirable provisions with respect thereto; (iii) to evidence the succession of another person to the State, and the assumption by any such successor of the covenants of the State under the State's Undertaking; (iv) to add to the covenants of the State for the benefit of the Holders, or to surrender any right or power therein conferred upon the State; (v) for any purposes for which, and subject to the conditions pursuant to which, amendments may be made under Rule 15c2-12, as amended or modified from time

to time, or any formal authoritative interpretations thereof by the Securities and Exchange Commission or its staff, which are applicable to the State Undertaking; or (vi) for any other purpose, if (a) the amendment is made in connection with a change in circumstances that arise from a change in legal requirements, change in law, or change in identity or nature, or status of the State or any type of business or affairs conducted by it; (b) the undertakings set forth in the State Undertaking, as amended, would have complied with the requirements of Rule 15c2-12 at the time of the primary offering of the Bonds, after taking into account any amendments, or formal authoritative interpretations by the Securities and Exchange Commission of Rule 15c2-12 as well as any change in circumstances; and (c) the amendment does not materially impair the interests of the Holders, as determined either by the Trustee or by nationally recognized bond counsel. (In determining whether or not there is such an adverse effect, the Trustee may rely upon an opinion of nationally recognized bond counsel.)

Termination. The State Undertaking will remain in full force and effect until such time as all principal, redemption premiums, if any, and interest on the Bonds will have been paid in full or the Bonds shall have been defeased pursuant to the Indenture; provided, however, that if Rule 15c2-12 (or successor provision) shall be amended, modified or changed so that all or any part of the information currently required to be provided thereunder shall no longer be required to be provided thereunder, then such information shall no longer be required to be provided under the State Undertaking; and provided, further, that if to the extent Rule 15c2-12 (or successor provision), or any provision thereof, shall be declared by a court of competent and final jurisdiction to be, in whole or in part, invalid, unconstitutional, null and void, or otherwise inapplicable to the Bonds, then the information required to be provided thereunder, insofar as it was required to be provided by a provision of Rule 15c2-12 so declared, shall no longer be required to be provided thereunder.

LITIGATION

There is no litigation pending or threatened in any court (either in State or federal court) to restrain or enjoin the issuance or delivery of the Series 2003B Bonds or questioning the creation, organization or existence of the Corporation, the validity or enforceability of the Act, the Sale Agreement, the Indenture, the Contract, the sale of the Pledged Settlement Payments by the State to the Corporation, the proceedings for the authorization, execution, authentication and delivery of the Series 2003B Bonds or the validity of the Series 2003B Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "BONDHOLDERS' RISKS," "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" and "APPENDIX F- CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY."

TAX MATTERS

Opinion of Bond Counsel. In the opinion of Bond Counsel, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein (i) interest on the Series 2003B Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2003B Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Corporation and the State in connection with the Series 2003B Bonds, and Bond Counsel has assumed compliance by the Corporation and the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Series 2003B Bonds from gross income under Section 103 of the Code.

Bond Counsel expresses no opinion regarding any other Federal or state tax consequences with respect to the Series 2003B Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation, or otherwise. Bond Counsel expresses no opinion on the effect of any action hereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Series 2003B Bonds, or under state or local tax law.

Certain Ongoing Federal Tax Requirements and Covenants. The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Series 2003B Bonds in order that interest on the Series 2003B Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Series 2003B Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the Series 2003B Bonds to be included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The Corporation has covenanted in the Indenture, and the State has covenanted in the Sale Agreement to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Series 2003B Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences. The following is a brief discussion of certain collateral Federal income tax matters with respect to the Series 2003B Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series 2003B Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Series 2003B Bonds.

Prospective owners of the Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S Corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise eligible for the earned income tax credit, and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for Federal income tax purposes. Interest on the Series 2003B Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount. Original issue discount ("**OID**") is the excess of the sum of all amounts payable at the stated maturity of a Series 2003B Bond (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the "issue price" of a maturity means the first price at which a substantial amount of the Series 2003B Bonds of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of Series 2003B Bonds is expected to be the initial public offering price set forth on the cover page of this Official Statement. Bond Counsel further is of the opinion that, for any Series 2003B Bonds having OID (a "**Discount Bond**"), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the Series 2003B Bonds.

In general, under Section 1288 of the Code, OID on a Discount Bond accrues under a constant yield method, based on periodic compounding of interest over prescribed accrual periods using a compounding rate determined by reference to the yield on that Discount Bond. An owner's adjusted basis in a Discount Bond is increased by accrued OID for purposes of determining gain or loss on sale, exchange, or other disposition of such Bond. Accrued OID may be taken into account as an increase in the amount of tax-exempt income received or deemed to have been received for purposes of determining various other tax consequences of owning a Discount Bond even though there will not be a corresponding cash payment.

Owners of Discount Bonds should consult their own tax advisors with respect to the treatment of original issue discount for Federal income tax purposes, including various special rules relating thereto, and the state and local tax consequences of acquiring, holding, and disposing of Discount Bonds.

Bond Premium. In general, if an owner acquires a Series 2003B Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on the Series 2003B Bond after the acquisition date (excluding certain "qualified stated interest" that is unconditionally payable at least annually at prescribed rates), that premium constitutes "bond premium" on that Series 2003B Bond (a "**Premium Bond**"). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term

of the Premium Bond, determined based on constant yield principles. An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost. Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange, or other disposition of Premium Bonds.

Possible Government Action. Legislation affecting municipal bonds is regularly under consideration by the United States Congress. In addition, the IRS has established an expanded audit program for tax-exempt bonds. There can be no assurance that legislation enacted or proposed or an audit initiated or concluded by the IRS after the issue date of the Series 2003B Bonds involving either the Series 2003B Bonds or other tax-exempt bonds will not have an adverse effect on the tax-exempt status or market price of the Bonds.

IRS Audits. The IRS examined several outstanding tax-exempt bond issues secured by tobacco settlement revenues. The IRS closed its examinations of the three earliest tax-exempt bond issues of this type on behalf of New York City, Westchester County, New York, and Nassau County, New York, respectively, with no change in the tax-exempt status of the interest on such bonds under Section 103 of the Code. Other pending IRS audits of tax-exempt bonds of this type, if any, or future IRS audits of tax-exempt bonds of this type or others, however, could adversely affect the tax-exempt status of the interest on the Series 2003B Bonds under Section 103 of the Code depending on any such determination and all the facts and circumstances. The pendency or outcome of any such IRS audit also could have an adverse effect on the market for or the market price of the Series 2003B Bonds.

New York Personal Income Tax Exemption. In the opinion of Bond Counsel, under the Act interest on the Series 2003B Bonds is exempt from personal income taxes imposed by the State of New York and its political subdivisions thereof, including The City of New York.

STATE NOT LIABLE ON THE SERIES 2003B BONDS

PURSUANT TO THE ACT, THE SERIES 2003B BONDS SHALL NOT CONSTITUTE A DEBT OR MORAL OBLIGATION OF THE STATE OR A STATE SUPPORTED OBLIGATION WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY PROVISION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF THE TAXING POWER OF THE STATE, AND THE STATE SHALL NOT BE LIABLE TO MAKE ANY PAYMENTS THEREON NOR SHALL ANY SERIES 2003B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER.

COVENANTS OF THE STATE

The Act states that the State pledges and agrees with the Corporation and the owners of the Corporation's Bonds that the State will (i) irrevocably direct, through the Attorney General, the independent auditor and the escrow agent under the MSA to transfer all Pledged Settlement Payments directly to the Trustee, (ii) enforce, at the expense of the State, its right to collect all monies due from the PMs under the MSA, (iii) diligently enforce, at the expense of the State, the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all tobacco product manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of the Attorney General, provided, however, as stated in the Sale Agreement, (a) that the remedies available to the Corporation and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (iii) shall be limited to injunctive relief, and (b) that the State shall be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) alter, limit or impair the Corporation's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested by the Act and the Indenture in the Corporation to fulfill the terms of its agreements with the Bondholders, or (c) in any way impair the rights and remedies of the 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 proceedings by or on behalf of the Bondholders, are fully paid and discharged (provided, that nothing in the Act or the Indenture shall be construed to preclude the State's regulation of smoking and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the Qualifying Statute and the Complementary Legislation in any way that would materially adversely affect the rights of, the Corporation or the Bondholders. Notwithstanding these pledges and agreements by the State, the Attorney General may in his or her discretion enforce any and all provisions of the MSA without limitation.

The State has covenanted in the Contract that the Director of the Budget on behalf of the State shall include, as a requested appropriation item in the State's budget for each State fiscal year, an amount equal to the amount certified by the Authorized Officer of the Corporation as being the amount of Scheduled Debt Service coming due during such next succeeding fiscal year.

RATINGS

S&P has rated the uninsured Series 2003B Bonds "AA-" and the Insured Series 2003A Bonds "AAA". Fitch has rated the uninsured Series 2003B Bonds "A+" and the Insured Series 2003B Bonds "AAA".

Such ratings will reflect only the view of such Rating Agencies, and an explanation of the significance of such ratings may be obtained from the Rating Agency furnishing the same. There is no assurance that any initial rating assigned to the Series 2003B Bonds will continue for any given period of time or that such rating will not be revised downward, suspended or withdrawn entirely by the Rating Agencies. Any such downward revision, suspension or withdrawal of a rating may have an adverse effect on the availability of a market for or the market price of the Series 2003B Bonds.

LEGAL INVESTMENTS

The Act provides that the Series 2003B Bonds are securities in which all public officers and bodies of the State and all municipalities and political subdivisions, all insurance companies and associations and other persons carrying on an insurance business, all banks, bankers, trust companies, savings banks and savings associations, including savings and loan associations, building and loan associations, investment companies and other persons carrying on a banking business, all administrators, guardians, executors, trustees and other fiduciaries, and all other persons whatsoever who are now or may hereafter be authorized to invest in bonds or in other obligations of the State, may properly and legally invest funds, including capital, in their control or belonging to them. The Act also provides that the Series 2003B Bonds are securities which may be deposited with and may be received by all public officers and bodies of the State and all municipalities, political subdivisions and public corporations for any purpose for which the deposit of bonds or other obligations of the State is now or hereafter may be authorized.

UNDERWRITING

The Fixed Rate Underwriters listed on the cover have agreed, subject to certain conditions, to purchase the Fixed Rate Bonds from the Corporation for a purchase price of $2,120,093,349.42 (representing the principal amount of the Fixed Rate Bonds, plus net original issue premium of $119,277,170.70 and less an underwriting discount of $14,598,821.28). The Fixed Rate Underwriters listed on the cover will be obligated to purchase all Fixed Rate Bonds if any such Fixed Rate Bonds are purchased.

Bear, Stearns & Co. Inc., has agreed, subject to certain conditions, to purchase the Series 2003B-2 Bonds from the Corporation for a purchase price of $39,894,761.44 (representing the principal amount of the Series 2003B-2 Bonds, less an underwriting discount of $105,238.56). Under such agreement, Bear, Stearns & Co. Inc. will be obligated to purchase all Series 2003B-2 Bonds if any such Series 2003B-2 Bonds are purchased.

Citigroup Global Markets Inc. has agreed, subject to certain conditions, to purchase the Series 2003B-3 Bonds from the Corporation for a purchase price of $39,894,761.44 (representing the principal amount of the Series 2003B-3 Bonds, less an underwriting discount of $105,238.56). Under such agreement, Citigroup Global Markets Inc. will be obligated to purchase all Series 2003B-3 Bonds if any such Series 2003B-3 Bonds are purchased.

UBS Financial Services Inc. has agreed, subject to certain conditions, to purchase the Series 2003B-4 Bonds from the Corporation for a purchase price of $69,815,832.52 (representing the principal amount of the Series 2003 B-4 Bonds, less an underwriting discount of $184,167.48). Under such agreement, UBS Financial Services Inc. will be obligated to purchase all Series 2003B-4 Bonds if any such Series 2003B-4 Bonds are purchased.

J.P. Morgan Securities Inc. has agreed, subject to certain conditions, to purchase the Series 2003B-5 Bonds from the Corporation for a purchase price of $74,802,677.71 (representing the principal amount of the Series 2003B-5 Bonds less underwriting discount of $197,322.29). Under such agreement, J.P. Morgan Securities Inc. will be obligated to purchase all Series 2003B-5 Bonds of any such Series 2003B-5 Bonds are purchased.

The Series 2003B Bonds may be offered and sold to certain dealers (including dealers depositing the Series 2003B Bonds into investment trusts) and institutional purchasers at prices lower than such public offering prices, and such public offering prices may be changed, from time to time, by the Underwriters.

Citigroup Global Markets Inc. is an affiliate of Citibank, N.A. which is acting as MSA Escrow Agent under the MSA. The firm and its affiliates also serve as an investment advisor to the MSA Escrow Agent.

The Series 2003B Bonds may be offered and sold to certain dealers (including dealers depositing the Series 2003B Bonds into investment trusts) and institutional purchasers at prices lower than such public offering prices, and such public offering prices may be changed, from time to time, by the Underwriters.

LEGAL MATTERS

Hawkins, Delafield & Wood, New York, New York, as Bond Counsel, will render the opinion with respect to the validity of the Series 2003B Bonds in substantially the form set forth in APPENDIX K hereto.

The State Attorney General will render the opinion simultaneously with the delivery of the Series 2003B Bonds that (i) the Act has been duly enacted by the State and is in full force and effect and (ii) the Contract has been duly authorized, executed and delivered by the State, and assuming the due execution and delivery by the Corporation, the Contract constitutes a legal, valid and binding obligation of the State, enforceable in accordance with its terms.

Certain legal matters will be passed upon for the Corporation by its Counsel.

Certain legal matters will be passed upon by Nixon Peabody LLP, New York, New York, as Disclosure Counsel to the Corporation and for the Underwriters by Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., New York, New York, as Underwriters' Counsel.

OTHER PARTIES

Financial Advisors

First Albany Capital, Inc. and US Bancorp Piper Jaffray (collectively, the "**Financial Advisors**"), have been retained to act as financial advisors for the Corporation in connection with the issuance of the Series 2003B Bonds.

The following sentence has been provided by the Financial Advisors. Although the Financial Advisors have assisted in the preparation of this Official Statement, the Financial Advisors are not obligated to undertake, and have not undertaken to make, an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

Global Insight

Global Insight has been retained by the Corporation as an independent econometric expert. The Global Insight Report attached as APPENDIX E hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as the Corporation's independent econometric consultant are not contingent upon the issuance of the Series 2003B Bonds. The Global Insight Report should be read in its entirety.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: /s/ James P. Angley
Senior Vice President

November 20, 2003

APPENDIX A

PROPOSED FORM OF CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION

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APPENDIX A
PROPOSED FORM OF CONTINGENCY CONTRACT BETWEEN THE STATE OF NEW YORK AND THE CORPORATION

THIS TOBACCO SETTLEMENT FINANCING CORPORATION CONTINGENCY CONTRACT, dated as of December 1, 2003 (the "Contract"), is by and between the Tobacco Settlement Financing Corporation, created and established as a subsidiary of the State of New York Municipal Bond Bank Agency and as a public benefit corporation, separate and apart from the State of New York (the "Corporation"), and the State of New York (the "State"), acting by and through the Director of the Budget of the State.

WHEREAS, pursuant to Part D3 of Chapter 62 of the Laws of 2003 (the Tobacco Settlement Financing Corporation Act) (the "Act"), the Corporation is authorized to purchase, for cash or other consideration, all or a portion of the State's Share (as defined in the Act), but the Act placed limitations upon the amount of bonds and other indebtedness which the Corporation was authorized to issue or incur for such purposes;

WHEREAS, in order to assist the Corporation in the undertaking and financing of the purchase of a certain portion of the State's Share through the issuance of its bonds, and in consideration of the undertaking thereof and the benefits to be derived therefrom by the people of the State, the Act authorizes the Director of the Budget, acting on behalf of the State, to enter into one or more contingency contracts with the Corporation whereunder the State would agree, subject to the making of annual appropriations therefor by the State Legislature, to provide to the Corporation the amount, if any, as necessary to meet the debt service requirements on one or more series of bonds of the Corporation in any year if the receipts from pledged tobacco revenues (as defined in the Act) or from an ancillary bond facility (as defined in the Act), if any, are inadequate and after, to the extent required by the Act, application of all other collateral pledged therefor, including any debt service and debt service reserve fund;

WHEREAS, this Contingency Contract is executed pursuant to the Act;

WHEREAS, pursuant to the Act, the Corporation entered into its Indenture dated as of December 1, 2003, between the Corporation and The Bank of New York, as Trustee (together with its permitted successors and assigns, the "Trustee"), as supplemented by its Series 2003B Supplement dated as of December 1, 2003, between the Corporation and said Trustee (as amended and supplemented, the "Indenture"), for the purpose of providing for the issuance of its Series 2003B Bonds or Refunding Bonds (as defined in the Indenture and, collectively, the "Bonds") and the securing of the repayment of said Bonds, including by a pledge under the Indenture of the Corporation's rights under this Contract; and

WHEREAS, terms not otherwise defined herein shall have the definitions assigned thereto under the Indenture;

NOW, THEREFORE, the parties mutually agree as follows:

I. Payments by the State

1.1. Subject to the provisions of Section 1.3 and Section 1.4, the State agrees to pay to the Corporation, on or before each Distribution Date of any year for which the Corporation shall

have outstanding Bonds secured by this Contract, the amount of money, if any, certified by the Chairman of the Corporation to the Director of the Budget and to the State Comptroller no later than five (5) business days prior to each such Distribution Date as the amount which is necessary, after taking into account application of all amounts of Collateral pledged therefor under the Indenture, including receipts from pledged tobacco revenues or from any ancillary bond facility or amounts in the Debt Service Account, the Debt Service Reserve Account or the Supplemental Account on the date of such certification to pay the scheduled principal (as to which the failure to make payment thereof constitutes a default under the Indenture, including mandatory sinking fund payments, if any) of and interest on the Bonds coming due on such next succeeding Distribution Date (herein "Scheduled Debt Service").

1.2. The State agrees that, subject to the provisions of Section 1.3 and Section 1.4, its obligations to make the payments provided for in this Article I shall be absolute and unconditional, without any rights of set-off, recoupment or counterclaim the State may have against the Corporation or any other person or entity having an interest in this Contract or the payments made hereunder.

1.3. Notwithstanding anything in this Contract to the contrary, (i) the obligation of the State to fund or to pay the amounts herein provided for is subject to annual appropriation by the State Legislature, (ii) the obligation of the State, to fund or to pay the amounts herein provided for shall not constitute a debt of the State, or pursuant to the Act, State supported debt, within the meaning of any constitutional or statutory provision and shall be deemed executory only to the extent of moneys available and no liability shall be incurred by the State beyond the moneys available and appropriated for such purpose, and (iii) the amounts paid to the Corporation pursuant to this Contract shall be applied by the Corporation solely for deposit under the Indenture to pay the Scheduled Debt Service.

1.4. Pursuant to the Act, the following is stated: this Contingency Contract shall not constitute a debt or moral obligation of the State or a State supported obligation within the meaning of any constitutional or statutory provision or a pledge of the faith and credit of the State or of the taxing power of the State, and the State shall not be liable to make any payments thereon nor shall this Contingency Contract be payable out of any funds or assets other than those received from the State under this Contingency Contract and pledged therefor under the Indenture.

1.5. To the extent that the Corporation shall obtain bond insurance for the Series 2003B Bonds (which provides for payment to bondholders in the event that Series 2003B Bonds are not paid from Collateral held under the Indenture), such bond insurance shall not be pledged as Collateral to the payment of the Series 2003B Bonds or otherwise considered an ancillary bond facility under the Indenture, amounts payable by the bond insurer shall not be Pledged Revenues under the Indenture, and the bond insurer shall not be a Beneficiary under the Indenture (except to the extent payments are made on the bond insurance). As a result, payments required to be made by the State pursuant to Section 1.1 hereof shall not take into account amounts due for payment under any such bond insurance policy.

II. Duties of the Corporation

2.1. The Corporation agrees to apply the net proceeds (as defined in the Act) from the sale of its Series 2003B Bonds to finance the purchase of a certain portion of the State's Share in accordance with the applicable provisions of the Act and the Indenture.

2.2. The Corporation agrees to deposit under the Indenture all amounts received pursuant to the Contract, which amounts shall be held, administered and applied by the Trustee, as provided in the Indenture, and shall not be commingled with any other funds of the Corporation.

III. Pledge and Assignment

3.1. The State hereby consents to the pledge and assignment by the Corporation under the Indenture for the benefit of the owners of any of its Bonds of all or any part of the benefits or rights of the Corporation herein and of the payments by the State as provided herein.

IV. Special Covenants

4.1. In accordance with the Act, the Corporation agrees to request from the State annually by certification of an authorized officer thereof to the Director of the Budget, by October 31st in each year, but in any event not later than December 15th of each year, an appropriation of an amount equal to the Scheduled Debt Service (provided that with respect to Auction Rate Bonds the amount of interest thereon shall be at the Maximum Rate of fifteen percent (15 %) per annum as set forth in the Indenture or with respect to other Bonds, if any, for which the interest thereon is subject to variation between Distribution Dates, the amount of interest thereon shall be at the maximum rate as set forth or as provided for in the Indenture) coming due during such next succeeding fiscal year.

4.2. In accordance with the Act, the State agrees that the Director of the Budget on behalf of the State shall include, as a requested appropriation item in the State's budget for such fiscal year, an amount equal to such certified amount.

4.3. The State agrees that whenever requested by the Corporation with reasonable advance notification it shall provide and certify, or cause to be provided and certified, in form satisfactory to the Corporation, such information concerning (A)(i) the State and various public authorities, or (ii) the operations and finances of the State and such other matters, that the Corporation considers necessary to enable it to complete and publish an official statement, placement memorandum or other similar document relating to the sale or issuance of Bonds, and (B) the payments to be made by the State as provided herein or any funds established under the Indenture, or information necessary to enable the Corporation to make any reports required by law or governmental regulations (including Rule 15c2-12, as amended, promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934) in connection with any Bonds.

4.4. Neither the Corporation nor the State shall terminate this Contract for any reason whatsoever including, without limiting the generality of the foregoing, any acts or circumstances which may constitute failure of consideration or frustration of purpose or the failure of either

party to perform and observe any duty, liability or obligation arising out of or connected with this Contract.

4.5. This Contract may not be amended, changed, modified or altered so as to adversely affect the rights of the owners of any Bonds, the payments to be made by the State as provided herein or the funds required by the Indenture without the consent of such owners or the Trustee given in accordance with the provisions of the Indenture.

V. Events of Default by the State and Remedies

5.1. If, for any reason (other than a failure by the State Legislature to appropriate moneys for such purpose), the State shall fail to pay when due any of the payments provided for in Section 1.1 or shall fail to observe or perform any other covenant, condition or agreement on its part to be observed or performed, the Corporation shall, if such default has not been cured, have the right to institute any action in the nature of mandamus or take whatever action at law or in equity may appear necessary or desirable to collect the payments then due or thereafter to become due or to enforce performance and observance of any obligation, agreement or covenant of the State hereunder.

5.2. The remedies conferred upon or reserved to the Corporation under Section 5.1 in respect of any default described therein are not intended to be exclusive of any other available remedy or remedies and shall be in addition to every other remedy now or hereafter existing at law or in equity; provided, however, that such remedy or remedies may in no event include a termination of this Contract, nor may they include any amendment, change, modification or alteration that is referred to in Sections 4.4 or 4.5.

VI. Events of Default by the Corporation and Remedies

6.1. If the Corporation shall fail to observe or perform any covenant, condition or agreement on its part to be observed or performed and such failure to observe or perform shall have continued for 60 days after written notice, specifying such failure and requesting that it be remedied, is given to the Corporation by the State, the State shall, if the default has not been cured, have the right to institute any action in the nature of mandamus or take whatever action at law or in equity may appear necessary or desirable to enforce the performance and observance of any obligation, agreement or covenant of the Corporation hereunder.

6.2. The remedies conferred upon or reserved to the State under Section 6.1 in respect of any default described therein are not intended to be exclusive of any other available remedy or remedies and shall be in addition to every other remedy now or hereafter existing at law or in equity; provided, however, that such remedy or remedies may in no event include a termination of this Contract or of the obligations of the State to make the payments provided for in Article I, nor may they include any amendment, change, modification or alteration of this Contract that is prohibited by Sections 4.4 or 4.5.

VII. Miscellaneous

7.1. This Contract shall be construed and interpreted in accordance with the laws of the State of New York.

7.2. This Contract may be executed in several counterparts, each of which shall be deemed to be an original, but such counterparts together shall constitute one and the same instrument.

7.3. In the event any provision of this Contract shall be held invalid or unenforceable by any court of competent jurisdiction, such holding shall not invalidate or render unenforceable any other provision hereof.

7.4. This Contract shall have a term ending on such date as there are no Bonds Outstanding under the Indenture.

7.5. The waiver by either party of a breach by the other shall not be deemed to waive any other breach hereunder nor shall any delay or omission to exercise any right or power upon any default impair any such right or power or be construed as a waiver thereof.

7.6. All notices for in this Contract shall be in writing and shall be delivered personally to be sent by certified or registered mail to the respective offices of the State and the Corporation as follows:

If to the State:	Director of the Budget State of New York Executive Department Division of the Budget State Capitol, Room 113 Albany, New York 12224
If to the Corporation:	Tobacco Settlement Financing Corporation c/o State of New York Municipal Bond Bank Agency 641 Lexington Avenue New York, New York 10022 Attention: Robert Drillings, Esq. Senior Vice President and Counsel

The Corporation or the State may from time to time designate in writing other representatives with respect to receipt of notices.

7.7. This Contract represents the entire agreement between the parties. It may not be amended or modified otherwise than by a written instrument executed by each of the parties. Such amendments shall not be contrary to the provisions of Sections 4.4 or 4.5.

7.8. Nothing in this Contract shall be construed to confer upon or to give notice to any person or entity other than the State, the Corporation, and the owners of any Bonds, the Trustee or any other trustee acting on their behalf, any right, remedy or claim under or by reason of this Contract or any provision thereof.

7.9. In accordance with the Act, neither the members of the Corporation nor any other person executing the Contract shall be subject to any personal liability or accountability by reason of the issuance or execution and delivery therof.

IN WITNESS WHEREOF, the State has caused this Contract to be executed in its name by the Director of the Budget and the Corporation has caused this instrument to be signed by its Executive Director as its duly authorized officer all as of the 1st day of December, 2003.

Approved as to form:
Attorney General

STATE OF NEW YORK

By:_____
Date:

_____
Director of the Budget

Approved as to form:
Counsel

TOBACCO SETTLEMENT
FINANCING CORPORATION

By:_____
Date:

_____
Authorized Officer

Approved:
State Comptroller

By:_____

Date:_____

APPENDIX B

INFORMATION CONCERNING THE STATE OF NEW YORK

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APPENDIX B

INFORMATION CONCERNING THE STATE OF NEW YORK

The State Legislature is not legally obligated to appropriate amounts for the payment of principal of, sinking fund installments, if any, or interest on the obligations to which this Official Statement relates. For information about the sources of payment of such obligations, the foregoing Official Statement to which this Appendix B is attached should be read in its entirety. The continued willingness and ability of the State, however, to make the appropriations and otherwise provide for the payments contemplated in the foregoing Official Statement, and the market for and market prices of the obligations, may depend in part upon the financial condition of the State.

Appendix B contains the Annual Information Statement of the State of New York ("Annual Information Statement" or "AIS"), as updated or supplemented to the date specified therein. The State intends to update and supplement that Annual Information Statement as described therein. It has been supplied by the State to provide information about the financial condition of the State in the Official Statements and Official Statements of all issuers, including public authorities of the State, that may depend in whole or in part on State appropriations as sources of payment of their respective bonds, notes or other obligations.

The AIS set forth in this Appendix B is dated May 30, 2003. It was updated on October 30, 2003 and contains information only through that date. Appendix B sets forth the section of the AIS entitled “Current Fiscal Year”. The remaining sections of the AIS set out under the headings “Prior Fiscal Years,” “Economics and Demographics”, “Debt and Other Financing Activities”, “State Organization”, “Authorities and Localities”, “Litigation”, and “Exhibits” are hereby included by cross reference. The AIS was also filed with each Nationally Recognized Municipal Securities Information Repository (NRMSIR). An official copy of the AIS may be obtained by contacting a NRMSIR, or the Division of the Budget, State Capitol, Albany, NY 12224, Tel: (518) 473-8705. An informational copy of the AIS is available on the Internet at http://www.budget.state.ny.us.

The General Purpose Financial Statements of the State of New York for the State fiscal year ended March 31, 2003 were prepared by the State Comptroller in accordance with generally accepted accounting principles and independently audited in accordance with generally accepted auditing standards. The General Purpose Financial Statements were issued on July 29, 2003 and have been referred to or set forth thereafter in appendices of information concerning the State in Preliminary Official Statements and Official Statements of the State and certain of its public authorities. The General Purpose Financial Statements of the State for the State fiscal year ended March 31, 2003 may be obtained by contacting the Office of the State Comptroller, 110 State Street, Albany, NY 12236 Tel: (518) 474-4015.

The Annual Information Statement of the State of New York (including any and all updates and supplements thereto) may not be included in an Official Statement or included by reference in an Official Statement without the express written authorization of the State of New York, Division of the Budget, State Capitol, Albany, NY 12224.

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Update to Annual Information Statement (AIS)
State of New York
October 30, 2003

This quarterly update (the "Update") to the AIS of the State of New York is dated October 30, 2003 and contains information only through that date. It is the second quarterly update to the AIS of the State of New York dated May 30, 2003. The first update to the AIS was issued on August 7, 2003. The information in this Update is organized into three parts.

Part I contains information on the State's Financial Plan projections. In Part I, readers will find:

1. The Mid-Year Update to the 2003-04 Financial Plan (the "Mid-Year Update") issued by the Division of the Budget (DOB) on October 28, 2003. Part I also reprints information on the GAAP-basis Financial Plan projections for 2003-04 and the State's five-year Capital Program and Financing Plan that first appeared in the in First Quarterly Update to the AIS issued on August 7, 2003. The full Capital Program and Financing Plan for the 2003-04 through 2007-08 fiscal years is incorporated by reference, and is available from DOB at the address below.

2. A discussion of special considerations affecting the State Financial Plan.

Part II contains updated disclosure on the State Retirement System, the Metropolitan Transportation Authority (MTA) and the City of New York. As a convenience to readers, Part II also reprints information related to the State's audited basic Financial Statements for the 2002-03 fiscal year that first appeared in the August 7, 2003 Update to the AIS.

Part III updates information related to certain litigation against the State.

This Update has been supplied by the State to provide information about the financial condition of the State in connection with financings of certain issuers (including public authorities of the State) that may depend in whole or in part on State appropriations as sources of payment of their respective bonds, notes or other obligations, and for which the State has contractually obligated itself to provide such information pursuant to an applicable continuing disclosure agreement (a "CDA").

An Official Copy of this Update has been filed with each Nationally Recognized Municipal Securities Information Repository (NRMSIR) and may be obtained by contacting a NRMSIR or the Division of the Budget, State Capitol, Albany, NY 12224, Tel: (518) 473-8705.

An Informational Copy of this Update is available on the DOB website (www.budget.state.ny.us). The availability of this Update in electronic form at DOB's website is being provided solely as a matter of convenience to readers and does not imply that there have been no changes in the financial condition of the State at any time subsequent to its release date. Maintenance of this Update on such website is not intended as a republication of the information therein on any date subsequent to its release date.

Neither this Update nor any portion thereof may be included or incorporated by reference in a Preliminary Official Statement, Official Statement, or other offering document without express written consent by DOB and agreement by DOB to execute a CDA relating to the series of bonds or notes described in such Preliminary Official Statement, Official Statement, or other offering document. Any use or incorporation by reference of this Update or any portion thereof in a Preliminary Official Statement, Official Statement, or other offering document without such consent and agreement is unauthorized and the State expressly disclaims any responsibility with respect to the inclusion, intended use, and updating of this Update if so misused.

PART I

Mid-Year Update to the 2003-04 Financial Plan

DOB prepared the Mid-Year Update set forth below. It contains estimates and projections of future results that should not be construed as statements of fact. These estimates and projections are based upon various assumptions that may be affected by numerous factors, including future economic conditions in the State and nation and potential litigation concerning actions by the State Legislature in enacting the 2003-04 budget. There can be no assurance that actual results will not differ materially and adversely from the estimates and projections contained herein.

Introduction

This is the Mid-Year Update to the State's 2003-04 Financial Plan, submitted pursuant to section 23 of the State Finance Law. The Mid-Year Update includes revised Financial Plan projections, an updated economic forecast, operating results for the first six months of fiscal year 2003-04, and General Fund cash flow projections through the third quarter of fiscal year 2003-04. For a description of the structure of the State Financial Plan and general State operating procedures, please see the 2003-04 New York State Executive Budget Appendix II published on January 29, 2003 and the Annual Information Statement of the State of New York dated May 30, 2003, which are available at www.budget.state.ny.us.

The actual cash-basis results and financial plan projections reported in this Mid-Year Update reflect the deferral of $1.9 billion in spending from 2002-03 to 2003-04 that was necessary due to delayed Legislative authorization for issuance of tobacco bonds. Therefore, the projections contained herein are reported on a basis consistent with the actual results reported by the State Comptroller, and with unadjusted Financial Plans previously reported in the Enacted Budget Report and First Quarterly Financial Plan Update.

In addition, the State Funds and All Governmental Funds actual results and estimates contained in this Update reflect the reclassification of the Expendable and Non-Expendable Trust Funds from the Fiduciary fund type to the Special Revenue fund type. This fund reclassification conforms to the new accounting standards as set forth in the Governmental Accounting Standards Board (GASB)

issued Statement 34, which substantially changed the way in which governments are required to report operations in their financial statements.

Overview

At mid-year, the State's 2003-04 Financial Plan remains solidly balanced based on the availability of one-time Federal aid that was authorized after this year's budget was enacted. While these receipts help to ensure balance in the current year, the State continues to face a significant financial gap in 2004-05.

Revenue actions enacted by the Legislature over the Governor's objection continue to perform as the Executive had anticipated, with no appreciable receipt collections from several newly authorized sources. Moreover, while the potential for improved performance from the financial services sector shows some promise, the level of revenue from tax law changes has not materialized to the extent anticipated by the Legislature at the time of their enactment. At the same time, governmental spending on economically sensitive entitlement programs is running higher than expected as the State's economic recovery remains anemic. Taken together, these factors represent a fiscal challenge for the 2004-05 fiscal year and beyond. As of this Mid-Year Report, the imbalance between anticipated receipts and disbursements for the 2004-05 fiscal year remains at approximately $5 billion to $6 billion.

As previously reported, a number of steps have been taken to address the State's fiscal situation. Aggressive austerity measures that require all State agencies to carefully scrutinize discretionary expenditures are in place, and a strict hiring freeze has been maintained. The Governor is also working with legislative leaders on statutory measures that could be enacted this fall to provide further savings this year and begin to address next year's gap.

As indicated, the Division of the Budget (DOB) projects the State will end the 2003-04 fiscal year in balance after year-end reserve transactions. These transactions, totaling $730 million, are comprised of $710 million in the permanent rainy day fund (the Tax Stabilization Reserve Fund) and $20 million in the Contingency Reserve Fund. An additional $75 million in resources, resulting primarily from minor timing revisions to the July Financial Plan projections, have been treated as available for use in 2004-05.

As detailed later in this report, the Mid-Year Update reflects modest net increases in both receipts and spending of $30 million from the July Update. The $30 million net increase in the revenue projections include modest upward revisions to tax receipts estimates. Nonetheless, tax receipt projections for the current fiscal year remain slightly below those contained in the Enacted Budget Report. The $30 million net increase in spending reflects higher spending in welfare and Medicaid due to increasing caseloads, expenditure growth and utilization and growth in the Tuition Assistance Program (TAP) due to higher enrollment. These costs are partially offset by the timing of Federal aid that lowers health care costs and savings resulting from recently enacted "clean-up" legislation. In addition, the report updates the status of certain risks to the Financial Plan

projections, including possible reductions in anticipated Federal aid for the school supportive health services program.

Current revenue and spending estimates for the General Fund, State Funds and All Governmental Funds are summarized in the following table. Detailed information is provided later in this report.

2003-04 Revenue and Spending Estimates (millions of dollars)				
	July Update	**October Update**	**Change from July Update**	**Change from Enacted Budget**
Revenue:				
General Fund	42,337	42,367	30	627
State Funds	62,539	62,647	108	592
All Governmental Funds	97,029	98,322	1,293	2,601
Spending:				
General Fund	42,422	42,452	30	(285)
State Funds	62,700	62,864	164	(123)
All Governmental Funds	96,918	97,979	1,061	1,605

Summary of Mid-Year Revisions

General Fund revenue projections have been revised upward by $30 million from the July Financial Plan Update issued July 30, 2003 (the "July Update") to reflect a modest upward revision in the tax receipts estimate offset by additional costs for the School Tax Relief (STAR) program and a deposit to the Personal Income Tax (PIT) Refund Reserve Account. The spending increase of $30 million is due to higher estimated costs in welfare ($31 million), Medicaid ($100 million), and TAP ($31 million), partially offset by Federal aid which reduces the State share of Medicaid costs ($51 million), other available health care resources ($46 million), implementation of cost containment in recently enacted "clean-up" legislation ($20 million), and projected additional lottery receipts used to finance school aid costs ($15 million).

State Funds disbursements increased by $164 million from the July Update reflecting General Fund changes described above ($30 million) and increased spending for STAR ($35 million). The reclassification of Expendable Trust and Non-Expendable Trust Funds from the Fiduciary Fund type to the Special Revenue fund type increases both receipts and disbursements ($60 million and $84 million, respectively) from amounts published in the July Update. The balance of the increase in the State Funds receipts of $108 million from the July Update primarily reflects the General Fund changes discussed above ($30 million).

The increase in All Governmental Funds receipts of $1.29 billion over the July Update primarily reflects the receipt of Federal Emergency Management Agency (FEMA) reimbursement aid for costs incurred by the State and New York City associated with the World Trade Center attacks of September 11th ($1.17 billion), as well as the State Funds changes described above ($108 million).

All Governmental Funds disbursements increased by $1.06 billion over the July Update due primarily to FEMA aid that flowed through the State to New York City for costs associated with the World Trade Center attacks ($885 million), and State Funds changes described above ($164 million).

Recap of Financial Plan Revisions since the Enacted Budget

Since the Enacted Budget Financial Plan, projected General Fund receipts have been increased by $627 million. This increase is attributable to the receipt of $645 million in one-time Federal revenue sharing payments and the expected flow of $170 million in additional sales tax receipts to the General Fund due to the delay in providing payments to New York City associated with the Local Government Assistance Corporation (LGAC)/Municipal Assistance Corporation (MAC) transaction. These increases are partially offset by a net reduction in the estimate for General Fund tax and miscellaneous receipts for 2003-04 of $53 million, additional costs for the STAR program of $35 million, an increased deposit into the PIT Refund Reserve Account of $75 million and a decrease in other transfers of $25 million.

General Fund spending has decreased by $285 million from the Enacted Budget Financial Plan. This decrease is primarily attributable to lower costs resulting from a 15-month increase in the Federal matching rate on Medicaid costs ($422 million), the delayed timing of spending for new legislative "member items" ($100 million), additional resources available to Medicaid ($46 million), lower debt service costs ($42 million) and savings from the cap on mentally disabled payments to counties ($20 million). These reductions in spending are partially offset by: growth above budgeted levels for Medicaid ($200 million), welfare ($71 million) and TAP ($31 million); the delayed implementation of employee health insurance cost containment changes ($26 million); and a modest increase in State operations spending ($17 million).

The combined benefit of the increased General Fund receipts and lower spending was used to balance the 2003-04 Enacted Budget and help lower the 2004-05 budget gap. The 2004-05 budget gap of roughly $5 billion to $6 billion already reflects these revisions.

State Funds receipts increased $592 million over the Enacted Budget Financial Plan primarily reflecting the General Fund increase described above ($627 million). The State Funds disbursements decline of $123 million reflects the decline in General Fund spending detailed above ($285 million) offset by increased spending in STAR ($35 million) and the reclassification of Expendable Trust and Non-Expendable Trust Funds from the Fiduciary fund type to the Special Revenue fund type ($84 million).

The increase in All Governmental Funds receipts of $2.60 billion over the Enacted Budget Financial Plan primarily reflects the receipt of Federal Emergency Management Agency (FEMA) reimbursement aid for costs incurred by the State and New York City associated with the World Trade Center attacks of September 11th ($1.17 billion), the State funds changes described above ($592 million), higher projected Federal aid in support of the Medicaid program reflecting the temporary increase in the Federal matching rate ($1.01 billion) and program cost increases ($300 million). All Governmental Funds disbursements increased $1.60 billion over the Enacted Budget

primarily due to increases in World Trade Center costs ($885 million) and the Medicaid increases detailed above ($1.31 billion), offset by decreases in all other program areas.

The majority of the changes since the Enacted Budget Financial Plan were reflected in the July Update, and thus only the incremental changes from the July Update are discussed in further detail later in this report.

Recent Events

The Legislature recently passed "clean-up" bills that provide technical corrections and clarification to the budget bills and Article VII language bills enacted in the 2003 regular legislative session. These bills include necessary corrections and clarifications to achieve several savings and revenue initiatives included in the 2003-04 Financial Plan, as well as $20 million in new cost containment savings (described in more detail below). In addition, the bills include a provision that grants loan forgiveness to local governments of roughly $172 million in advance payments associated with the cost of providing mental health services. This action was already reflected in the Financial Plan.

Status of Legislative Actions

DOB continues to value certain revenue measures adopted by the Legislature at significantly lower amounts. The temporary personal income tax increase is valued at $280 million below legislative estimates, and year-to-date results appear consistent with the lower estimate. In addition, more speculative revenue actions taken by the Legislature are expected to have virtually no positive revenue impact in the current fiscal year, again, consistent with results to date. These actions include Video Lottery Terminals (VLTs) permitted to operate at certain racetracks, the collection of excise and sales taxes from non-exempt purchasers on Native American lands, and the denial of business deductions for the use of certain intangible assets.

DOB Analysis of 2003-04 Legislative Revenue Actions
(millions of dollars)

	Legislative Value	DOB Value
Temporary PIT Increases	1,680	1,400
Indian Reservation Taxes	164	0
VLTs	150	0
Bonus Depreciation Recapture	146	58
Intangible Holding Companies	115	0
Other Revenue Actions	140	15

It should also be noted that the Legislature assumed savings in certain program areas that have not been attainable and which are still not reflected in this Update. These occur primarily in Medicaid and in shelter allowances for welfare recipients.

Projected General Fund Outyear Budget Gaps

While the current fiscal year is balanced, the magnitude of future budget gaps requires timely and aggressive measures to restore structural balance. The Governor is continuing implementation of a fiscal management plan that includes measures intended to reduce costs and generate recurring savings in the outyears. General Fund outyear budget gaps are estimated to be roughly $5 billion to $6 billion in 2004-05 and $8 billion in 2005-06, consistent with the range of gaps initially reported by DOB in the May 1 Analysis of Legislative Budget Changes and in the Enacted Budget Report released later in May.

The statewide austerity measures limiting discretionary spending, travel, and low priority capital spending will remain in force and all State agencies will continue to operate under a hiring freeze, consistent with existing guidelines. In addition, agencies continue to conduct comprehensive reviews of all existing and new State contracts, fleet management practices, and equipment purchases, as well as management assessments of current agency operations. These reviews will identify opportunities where agencies, through increased administrative flexibility, statutory changes or other means, can achieve greater productivity, improve services, and reduce costs. Savings from these measures, which are not yet reflected in the Financial Plan, should provide a hedge against risk for the remainder of the fiscal year and help reduce the outyear budget gaps.

General Fund Financial Plan

National Economy

Revised data for the second quarter of this year, in conjunction with preliminary data for the third quarter, indicate a stronger national economy for 2003 than projected in the July Update. Indeed, U.S. real gross domestic product is expected to grow almost 6 percent during the third quarter, aided by the issuance of tax cut rebate checks and a long-awaited improvement in business spending. Consequently, the DOB forecast for real growth in U.S. GDP for 2003 has been revised up to 2.8 percent. National economic growth is expected to accelerate to 3.8 percent in 2004.

The improved outlook for the overall national economy has not yet translated into significant labor market growth. High productivity growth, rising benefit costs, and the trend toward off-shore outsourcing in certain economic sectors has delayed the resumption of hiring by businesses. DOB has reduced its estimate of nonagricultural employment growth for 2003 slightly from the 0.2 percent decline reported in July to a decline of 0.3 percent. Moreover, expected growth for 2004 has been reduced from 0.9 percent to 0.6 percent. The weaker job market, along with slightly lower than expected consumer price inflation, will result in slower wage and personal income growth than reported in the July Update. Wage growth has been revised down from 2.8 percent to 2.1 percent for 2003, partly due to a downward revision to the first quarter of 2003. Overall personal income growth has been revised down as well from 3.5 percent to 3.2 percent. Income growth is expected to accelerate in 2004, but remains well below the historical average.

Major Economic Indicators			
	2002	**2003**	**2004**
Gross Domestic Product (real)	2.4	2.8	3.8
Personal Income	2.7	3.2	4.7
Non Farm Employment	(0.3)	0.6	1.7
Consumer Price Index	1.6	2.3	1.9
Note: Numbers above are percent change/calendar year. DOB estimates are based on National Income and Product Account data through September 2003.			

DOB's forecast is not without risk. With significant labor market slack and the capacity utilization rate at its lowest level since the early 1980s recession, the business sector has been more reluctant to significantly increase investment spending than is typical at this stage of a recovery. If this trend continues, it could result in even slower job growth than expected. In turn, continued weakness in the labor market could depress consumption spending, further reducing the incentive for businesses to spend. In contrast, if the Federal tax reduction, combined with historically low interest rates, has a greater impact on households than expected, or a weaker dollar produces higher export growth than the current forecast, national economic growth could be stronger than expected.

State Economy

DOB's New York State Index of Coincident Economic Indicators shows that the State economy began to emerge from recession in early 2003. The collapse of dot-com equity prices, and the implosion of the high-tech sector that followed, sent the stock market tumbling and precipitated heavy job losses in the State's manufacturing, trade, and finance industries during the first eight months of 2001. The destruction of the World Trade Center wrought catastrophe for the downstate economy, with the finance and travel and tourism industries being the hardest hit. The December 2001 collapse of Enron, the corporate governance scandals that followed, and finally, the run-up to the war in Iraq, further delayed the recovery in equity prices, leading to further financial sector layoffs, as well as reductions in bonuses. As a result of this barrage of negative events, the State recession extended beyond that of the nation.

Notwithstanding the upward revision to the national economic forecast, DOB's outlook for the New York economy is little changed from that presented in the July Update. With the State's labor market beginning to recover, DOB has revised its 2003 forecast for total State employment growth marginally upward from a decline of 0.4 percent to a decline of 0.1 percent, on an annual average basis. Private sector job growth has similarly been revised up from a decline of 0.2 percent to a decline of 0.1 percent. Expected employment growth for 2004 has also been revised upward from 0.6 percent to 0.8 percent. Nevertheless, the estimate for the State's unemployment rate, which is often a lagging economic indicator, remains at 6.2 percent for both 2003 and 2004.

The recovery of the State's financial sector continues. With the S&P 500 up over 13 percent since the end of 2002, recent months have seen an increase in merger and acquisition activity, as well as strong revenues from bond trading activity, although the latter are expected to weaken with the rise in long-term interest rates. The improved outlook for the financial markets is expected to translate into higher bonus growth for the coming bonus season than was projected in July. DOB's 2003 forecast for State wages and salaries is relatively unchanged from July, but has been revised up for 2004 from 4.1 percent to 4.6 percent. Growth in total State personal income, of which wages and salaries are the largest component, has been revised up to 2.7 percent for 2003, due in large part to revised data for proprietors' income, and to 4.4 percent for 2004.

Major Economic Indicators			
	2002	**2003**	**2004**
Personal Income	(0.2)	2.7	4.4
Nonagricultural Employment	(1.8)	(0.1)	0.8
Unemployment Rate	6.1	6.2	6.2
Note: Numbers above are percent change/calendar year. Personal income and nonagricultural employment growth for 2002 and all forecasts for 2003 and 2004 are projected by DOB.			

The volatility of the financial markets remains a significant source of risk to the New York forecast. If the recent rise in equity prices and financial services activity fails to be sustained, industry profitability and associated compensation could be lower than anticipated. In addition, weaker than expected growth for both the national and international economies would, in turn, weaken the State's recovery. This would result in even slower employment and income growth than projected. In contrast, stronger financial services sector growth or stronger national and international growth could result in a healthier economic recovery for the State than projected.

General Fund Receipts

2003-04 General Fund Receipts (millions of dollars)				
	July Update	**October Update**	**Change from July Update**	**Annual Change**
Total Tax Receipts	28,406	28,402	(4)	425
All Other Receipts	13,931	13,965	34	4,546
Total Receipts	**42,337**	**42,367**	**30**	**4,971**

Total General Fund receipts are estimated at $42.37 billion, an increase of $30 million from the July Update, as explained below. The increase of $4.97 billion over the prior year is largely attributable to three factors: the expected receipt of $3.80 billion in tobacco securitization proceeds, $645 million from the Federal revenue sharing grants, and higher receipts resulting from tax and fee increases enacted with the 2003-04 Budget. The tax receipt revisions from the July Update, including transfers, are relatively minor and reflect a modestly more optimistic view of economic trends and financial sector performance balanced against some shortfalls in year-to-date results. Estimates for the impact of legislatively enacted changes remain essentially unchanged. It remains

the case that a significant number of the revenue actions taken by the Legislature will generate little or no revenue in fiscal year 2003-04.

Personal Income Tax

Personal income tax receipts for the 2003-04 fiscal year are estimated at $16.28 billion, a decrease of $8 million from the July Update estimate. This decrease is comprised of an additional deposit to the PIT Refund Reserve Account ($75 million) partially offset by higher PIT collections ($67 million). The estimate reflects an increase of $150 million in the non-withholding payments estimate due in part to a change in collection patterns related to tax actions taken with the Enacted Budget. Despite a year-to-date shortfall in withholding results, the estimate is unchanged reflecting better-than-anticipated securities industry profitability and an expected increase in end-of-year bonus payments. Increases are partially offset by a lower assessments estimate ($25 million), increased costs for the STAR program ($35 million) and greater deposits to the Revenue Bond Tax Fund (RBTF) ($23 million). Important risks affecting the personal income tax estimate include the strength of growth in the overall economy, financial sector compensation trends, and collection patterns related to the temporary tax increase enacted earlier this year.

Consumption and Use Taxes

The estimate for user taxes and fees is $7.96 billion, which is $11 million below the July Update. The estimates for sales tax, motor vehicle fees, the alcohol beverage tax, and alcohol beverage control license fees are unchanged from the July Update. The estimate for the cigarette and tobacco tax is $11 million below the July Update estimate, reflecting weaker-than-anticipated cigarette consumption. Overall, consumption and use tax receipts are within $5 million of the estimated cash flow contained in the July Update.

Business Taxes

The business tax estimates total $3.44 billion and remain unchanged from the July Update. Business taxes for the first half of the fiscal year were $1.54 billion, which is $43 million below July estimates. This is primarily due to unexpected large refunds in the bank tax and lower-than-expected utility tax payments. Collections are expected to strengthen in the later part of the year as corporate profitability continues to improve.

Other Taxes

Other taxes, comprised of the estate tax, gift tax, real property gains tax, pari-mutuel taxes and other taxes are now expected to total $726 million, a $15 million increase from the July Update. Through the first half of the fiscal year, receipts totaled $398 million, which is $32 million above the cash flow projection in the July Update. The change from the July Update is due to the unexpectedly strong results in the estate tax. The change is based upon the strong year-to-date results, and an upward revision to estimates of household net worth.

Miscellaneous Receipts

The estimate for miscellaneous receipts is $5.55 billion and remains unchanged from the July Update. Year-to-date collections of miscellaneous receipts are $3.13 billion, which is $2.27 billion

higher than last year. The higher receipts are attributable to $2.20 billion in tobacco bond proceeds received in June, offset by lower collections from abandoned property. There is some downside risk in the miscellaneous receipts estimate, stemming from lower-than-expected year-to-date collections from abandoned property, though the majority of revenue from this source is received during the second half of the fiscal year.

Federal Grants

Federal Grants are estimated to total $645 million and remain unchanged from the July Update.

Transfers From Other Funds

The estimate for transfers from other funds is $7.77 billion, which is $34 million above the July Update. Personal income tax and the real estate transfer tax in excess of debt service requirements are expected to increase by $23 million and $11 million respectively. These changes reflect modest increases in the estimates of the personal income and real estate transfer taxes.

General Fund Disbursements

2003-04 General Fund Disbursements (millions of dollars)				
	July Update	**October Update**	**Change from July Update**	**Annual Change**
Grants to Local Governments	29,584	29,629	45	4,742
All Other	12,838	12,823	(15)	97
Total Disbursements	**42,422**	**42,452**	**30**	**4,839**

General Fund spending is estimated at $42.45 billion, an increase of $30 million from the July Update as a result of additional net spending of $45 million for Grants to Local Governments partially offset by the anticipated elimination of a $15 million transfer to the State Lottery Fund.

Grants to Local Governments disbursements are projected at $29.63 billion, an increase of $45 million from the July Update. This higher local spending consists of increases in welfare ($31 million), TAP ($31 million), and Medicaid ($3 million), partially offset by reduced spending in mental hygiene programs ($20 million).

Revised welfare caseload and expenditure estimates result in a net $31 million spending increase above the July Update. Federal Temporary Assistance to Needy Families (TANF) originally programmed to offset school aid costs for the Pre-K program and Higher Education Services Corporation (HESC) spending for the TAP program are now needed to fund welfare costs. As a result, school aid and HESC spending increases by $50 million and $70 million respectively, partially offset by a welfare realignment of $89 million after the TANF reprogramming, including $23 million in TANF bonus funds.

In addition to the loss of $70 million of TANF funds to offset TAP spending from the General Fund, HESC local assistance spending is $31 million above the July Update estimate as a result of larger than projected growth in the number of TAP recipients and average award levels.

Medicaid spending increased by a net $3 million over the July Update estimate as a result of $100 million in higher costs relating to caseload and utilization ($96 million) and revised cost containment savings ($4 million). This growth is partially offset by an increased State benefit resulting from the 15-month increase in the Federal matching rate used to lower Medicaid costs ($51 million). The gross State benefit of $319 million (for a total State share benefit in 2003-04 of $690 million) is reduced by $268 million to reflect the portion of these savings used to finance programs under the Health Care Reform Act. In addition, there are other available resources to Medicaid to reduce current year costs ($46 million).

Local assistance spending estimates for the Office of Mental Retardation and Developmental Disabilities were reduced by $20 million from the July Update estimate due to the implementation of a cap on mentally disabled payments to counties pursuant to the recently enacted "clean-up" bills.

Transfers from the General Fund to other funds are reduced by $15 million for the anticipated elimination of a transfer to the Lottery Fund assumed in the July Update. This transfer is no longer required due to an increase in estimated lottery receipts that sufficiently funds a portion of school aid costs as assumed in the Enacted Budget Financial Plan.

All other General Fund spending estimates, including State Operations ($7.14 billion), General State Charges ($3.26 billion), Debt Service ($1.54 billion) and Capital Projects ($255 million), remain unchanged from the July Update.

Annual Change in General Fund Disbursements

General Fund spending is now projected to total $42.45 billion, an increase of $4.84 billion or 13.0 percent from the prior year. The deferral of $1.90 billion in disbursements from 2002-03 to 2003-04 that was made necessary due to the delay in securing authorization to issue tobacco bonds represents $3.80 billion of the annual growth in General Fund spending. The deferral of $1.9 billion in payments included school aid ($1.31 billion), CUNY Senior Colleges advance ($419 million), Medicaid to New York City relating to the mentally disabled ($82 million), education ($54 million), welfare ($47 million) and several other payments ($186 million).

The remaining $1.04 billion in projected annual spending growth in the General Fund is primarily attributable to increased spending for Grants to Local Governments of $1.09 billion. This category is the largest area of General Fund spending and represents over 68 percent of total disbursements. All other General Fund spending is estimated to decrease by $51 million and consists of lower spending for State Operations ($610 million), offset by increases in General State Charges ($493 million) and Transfers To Other Funds ($66 million).

Higher local assistance spending of $1.09 billion or 4.1 percent results from higher welfare spending associated with the loss of non-recurring Federal TANF reserve funds used to offset 2002-

03 welfare spending and an increased caseload ($582 million), additional spending for legislative member items ($250 million), growth in Medicaid program costs ($130 million), and various other increases in spending across several local assistance programs.

State Operations disbursements, which accounts for the second largest area of General Fund spending, are estimated to decline $610 million or 7.9 percent from 2002-03 due to decreased spending for personal service ($677 million) partially offset by modest growth in non-personal service spending ($67 million).

Decreases in personal service costs are attributable to the continuation of the strict statewide hiring freeze, an aggressive use of a State employees retirement incentive, and the use of alternative funding sources to finance spending. These alternative funding sources for personal service costs are comprised of additional SUNY revenues including a tuition increase ($289 million), increased Federal revenues used to finance a portion of mental hygiene spending ($227 million), and the shift of transportation-related spending for the Department of Motor Vehicles to the Dedicated Highway Fund ($90 million). This lower spending is partially offset by increased non-personal service spending resulting primarily from inflationary increases across all agencies.

General State Charges annual growth of $493 million or 18.0 percent is mostly due to higher costs associated with pensions ($250 million) and health insurance ($204 million). Increases in pension costs are driven by a required minimum contribution rate of 4.5 percent of 2003-04 annual payroll expenditures (versus 1.0 percent in 2002-03), as well as higher costs produced by retirement incentives. The growth in health insurance spending reflects rising costs of employee and retiree health care, including the escalating costs of prescription drugs.

Transfers to other funds are projected to grow $66 million or 2.8 percent over the prior year, primarily the result of timing of State subsidy payments to the SUNY hospitals ($107 million), increased General Fund support of capital projects spending for transportation and the environment ($90 million), and underlying growth in debt service costs ($46 million). These increases are partially offset by a decrease in the transfer to the Community Service Provider Assistance Program Fund ($100 million) and in the State's share of Medicaid payments to SUNY hospitals ($48 million).

Additional information relating to the annual spending changes is included in the 2003-04 Enacted Budget Report published on May 28, 2003.

Reserves/General Fund Closing Balance

The Mid-Year Update projects a closing balance of $730 million in the General Fund, and is unchanged from the July Update. The closing fund balance is comprised of $710 million in the permanent rainy day fund (Tax Stabilization Reserve Fund) and $20 million in the litigation reserve (Contingency Reserve Fund).

Certain Risks[1]

The Mid-Year Financial Plan does not assume costs that could materialize as a result of adverse rulings in pending litigation, increased school aid funding related to recent court rulings, future collective bargaining agreements with State employee unions, Federal disallowances or other Federal actions that could produce adverse effects on the State's projections of receipts and disbursements. These risks are explained in further detail below.

The State is a defendant in several ongoing legal proceedings that could result in costs to the State Financial Plan. The most significant litigation includes ongoing claims by several Indian Nations alleging wrongful possession of lands by the State and several counties, and the recent State Court of Appeals ruling that the State's financing system for New York City public schools was unconstitutional requiring the State to submit its remedy to the Court by July 30, 2004. In addition, in *Jiggetts vs. Dowling*, the State has implemented a court-ordered increase in the shelter allowance schedule for public assistance families effective November 1, 2003. The court has also directed the parties to return on March 30, 2004 for further proceedings.

The State and several State employee unions are negotiating new collective bargaining agreements. The recently expired four-year agreement included a $500 non-recurring lump sum payment and salary increases of 1.5 percent in 1999-00, 3.0 percent in 2000-01 and 3.5 percent in 2001-02 and 2002-03. Each one percent salary increase costs roughly $80 million in the General Fund.

The Federal government is currently auditing Medicaid claims submitted since 1993 under the school supportive health services program. At this point, these audits have not been finalized, and, as a result, the liability of the State and/or school districts for any disallowances that may result from these audits cannot be determined. Federal regulations include an appeals process that could postpone repayment of any disallowances.

In addition, as of September 2003, nearly $300 million in Federal Medicaid payments related to school supportive health services have been deferred by the Federal Centers for Medicare and Medicaid Services. Since the State has continued to reimburse school districts for these costs, these Federal deferrals, if not resolved, could result in a Medicaid cash shortfall in the General Fund.

New York State continues to await Federal approval of the Medicaid State Plan Amendment necessary to make planned payments totaling roughly $1.1 billion (half funded by the Federal government) to public hospitals throughout the State, including the New York City Health and Hospitals Corporation, State University of New York hospitals, and other State and county operated facilities.

[1] For a discussion of other risks, please see "Special Considerations" and "Litigation" in this Update.

Governmental Funds Financial Plans

The State Funds and All Governmental Funds sections below provide a brief description of the annual change in receipts and disbursements. For a more detailed discussion of these changes, refer to the Enacted Budget Financial Plan.

GASB issued Statement 34 (GASB 34), which substantially changed the way in which governments are required to report their operations in their financial statements. In accordance with GASB 34, the Expendable and Non-Expendable Trust Funds have been reclassified from the Fiduciary fund type to the Special Revenue fund type. These fund reclassifications conform to the new accounting standards and are counted in the State Funds and All Governmental Funds actual results and estimates contained in this Update.

State Funds

State Funds represent the portion of the State's budget supported exclusively by State revenues: taxes, fees, fines, and other revenues imposed and collected by the State. Federal grants are not typically included as part of State Funds; however, one-time Federal grants received in the General Fund have been included for 2003-04.

2003-04 State Fund Receipts (millions of dollars)

	July Update	October Update	Change from July Update	Annual Change
Taxes	42,534	42,577	43	1,901
Miscellaneous Receipts	19,360	19,424	64	5,421
Federal Grants	645	646	1	646
Total Receipts	**62,539**	**62,647**	**108**	**7,968**

The increase in State Funds receipts of $108 million over the July Update is primarily attributable to General Fund changes including projected increases in tax collections ($43 million). The remaining State Funds receipts change reflects the reclassification of Expendable and Non-Expendable Trust Funds to the Special Revenue Funds pursuant to GASB 34 as discussed above ($60 million).

State Funds receipts are projected to total $62.65 billion in 2003-04, an increase of $7.97 billion or 14.6 percent from 2002-03. Tax receipts in State Funds are projected to total $42.58 billion, an increase of $1.90 billion from 2002-03 primarily reflecting a new personal income tax surcharge ($1.4 billion) and a one-quarter percent increase in sales tax ($450 million) as well as other modest tax reestimates. Miscellaneous receipts in State Funds are projected to total $19.42 billion, an increase of $5.42 billion over 2002-03. The growth in miscellaneous receipts primarily reflects receipts from the issuance of tobacco bonds ($3.8 billion), receipt of bond proceeds in support of capital spending ($1.29 billion) and growth in SUNY revenues attributable to a tuition increase ($280 million). Federal grants are projected to total $646 million and reflect one-time Federal revenue sharing payments.

2003-04 State Funds Disbursements (millions of dollars)			
July Update	**October Update**	**Change from July Update**	**Annual Change**
62,700	62,864	164	7,111

State Funds disbursements increased by $164 million from the July Update. Spending growth is due mostly to General Fund changes, including welfare caseload increases ($31 million) and higher than expected enrollment in the current academic year for TAP ($31 million). The remaining change reflects increased spending in STAR for higher than anticipated school tax increases ($35 million) and fund reclassifications made pursuant to GASB 34 as discussed above ($84 million).

State Funds disbursements are projected at $62.86 billion in 2003-04, an increase of $7.11 billion or 12.8 percent from 2002-03. The deferral of payments made necessary due to the delay in securing authorization to issue tobacco bonds accounts for $3.8 billion of the $7.11 billion increase.

Spending growth in welfare and HESC ($582 million and $210 million, respectively) results primarily from the loss of non-recurring Federal TANF reserve funds that had previously helped offset 2002-03 General Fund spending.

Other State Funds spending growth includes increases in: General State Charges ($543 million) primarily due to higher pension and health insurance costs; Medicaid ($249 million) reflecting growth in program costs; and debt service ($349 million), reflecting planned growth in costs and additional bonding enacted by the Legislature.

The remaining annual growth includes: legislative member items ($250 million), public health ($195 million), SUNY ($183 million), STAR ($171 million), transportation ($136 million), environmental conservation ($117 million) and children and family services ($105 million).

All Governmental Funds

All Governmental Funds includes activity in the four governmental fund types: the General Fund, Special Revenue Funds, Capital Projects Funds, and Debt Service funds. All Governmental Funds spending combines State Funds with Federal grants across these fund types.

2003-04 All Governmental Fund Receipts (millions of dollars)				
	July Update	**October Update**	**Change from July Update**	**Annual Change**
Taxes	42,534	42,577	43	1,901
Miscellaneous Receipts	19,582	19,555	(27)	5,413
Federal Grants	34,913	36,190	1,277	2,934
Total Receipts	**97,029**	**98,322**	**1,293**	**10,248**

The increase in All Governmental Funds receipts of $1.29 billion over the July Update primarily reflects the receipt of Federal Emergency Management Agency (FEMA) reimbursement aid for World Trade Center costs ($1.17 billion), and the State Funds changes described above ($108 million).

All Governmental Funds receipts are projected to be $98.32 billion in 2003-04, an increase of $10.25 billion or 11.6 percent from 2002-03. The growth in receipts is comprised of the State Funds increase of $7.97 billion discussed above, and additional growth of $2.29 billion in Federal grants. The annual increase in Federal grants primarily reflects the receipt of FEMA aid as described above ($1.13 billion) and higher projected Federal aid in support of the Medicaid program reflecting the temporary increase in the Federal matching rate ($1.01 billion) and program cost increases ($300 million).

2003-04 All Governmental Funds Disbursements (millions of dollars)

July Update	October Update	Change from July Update	Annual Change
96,918	97,979	1,061	8,923

All Governmental Funds disbursements increased by $1.06 billion over the July Update due to FEMA aid that flowed through the State to New York City for costs incurred associated with the World Trade Center attacks ($885 million), and the State funds changes described above ($164 million).

All Governmental Funds spending is projected to total $97.98 billion in 2003-04, an annual increase of $8.92 billion or 10 percent from 2002-03. All Governmental Funds Medicaid spending growth of $2.51 billion primarily reflects underlying spending growth ($1.40 billion), the temporary increase in the Federal matching rate ($1.01 billion), and increased aid for disproportionate share payments to public hospitals ($394 million), as well as the State Funds changes described above ($249 million).

Also included in the annual increase is higher spending for public health ($475 million), largely related to the Child Health Plus program ($319 million), and welfare ($225 million), which reflects the State Funds increase described above ($582 million) partially offset by decreased Federal spending primarily due to the loss of one-time TANF aid that was used to support 2002-03 spending.

All Governmental Funds spending growth largely attributable to State Funds spending includes growth for fringe benefits ($525 million), debt service ($349 million), legislative member items ($250 million), SUNY ($160 million), and STAR ($171 million).

Mid-Year Cash-Basis Results

General Fund

Cumulative General Fund Cash Flow Results April 1, 2003 through September 30, 2003 (millions of dollars)			
	July Plan	**Actuals**	**Favorable (Unfavorable) Variance**
Total Receipts	21,764	21,649	(115)
Total Disbursements	20,316	19,905	411
Cash Balance	2,263	2,559	296

The General Fund ended the second quarter with a balance of $2.56 billion, $296 million higher than the estimate in the July Update to the Financial Plan. The variance primarily reflects timing delays in projected spending of $411 million partially offset by lower receipts of $115 million.

Total General Fund receipts, including transfers from other funds, were $21.65 billion in the first six-months. On a net basis, receipts were $115 million lower than the July Update cash flow projections. This variance is primarily attributable to the delay in a transfer from the Dedicated Highway Fund ($118 million), lower sales and business taxes ($46 million) and lower gross personal income tax receipts ($21 million), which are partially offset by higher miscellaneous receipts ($29 million) and other taxes ($32 million).

General Fund disbursements, including transfers to other funds, totaled $19.91 billion through the second quarter, and were $411 million lower than the estimate of disbursements in the July Update. This lower spending consists of slower than anticipated 2002-03 school year aid payments primarily for categorical aid programs to school districts ($178 million), timing delays in capital projects in the economic development, environment, education and general government areas ($113 million), and a delay in the receipt of Federal Medicaid disproportionate share monies which are then transferred to SUNY hospitals ($92 million). Almost all of these timing variances are expected to be paid by the end of December and should have no impact on year-end projections, with the exception of the pending Federal approval of the Medicaid State Plan Amendment to make additional intergovernmental transfers and disproportionate share (IGT/DSH) payments to public hospitals as discussed earlier in this document which could result in higher costs.

State Funds

Total State Funds receipts were $30.15 billion in the first six months of 2003-04 comprised of $20.48 billion in taxes and $9.67 billion in other receipts. State Funds tax receipts are projected to total $42.58 billion at year-end and all other receipts are projected to total $20.07 billion. State Funds receipts through September represent 48 percent of total year-end projections which is consistent with financial plan assumptions that closely mirror State Funds disbursements.

State Funds disbursements totaled $28.42 billion through the second quarter against projected year-end total disbursements of $62.86 billion. Disbursements through September from State Funds amount to 45 percent of total projected disbursements consistent with underlying cash flow assumptions which plan for the disbursement of substantially all of the STAR local tax relief payments, significant school aid payments and Medicaid payments supported by HCRA monies in the second half of the fiscal year.

All Governmental Funds

All Governmental Funds receipts totaled $48.81 billion in the first six months of 2003-04 comprised of $20.48 billion in taxes, $9.44 billion in miscellaneous receipts and $18.89 billion in Federal grants. All Governmental Funds receipts are projected to total $98.32 billion at year-end: $42.58 billion in taxes, $19.56 billion in miscellaneous receipts, and $36.19 billion in Federal grants.

Total All Governmental Funds disbursements were $46.23 billion through September against projected year-end total disbursements of $97.98 billion. All Governmental Funds receipts and disbursements through September are consistent with cash flow assumptions made in development of the Financial Plan projections and represent 49 percent and 47 percent of total year-end estimates, respectively.

General Fund Cash Flow Projections

Actual month-end cash balances through September ranged from a low of $1.33 billion in August to a high of $2.79 billion in April. Total receipts through September included $2.20 billion in tobacco proceeds and $323 million in Federal revenue sharing received in June, which allowed for the repayment of all pending March 2003 payment delays totaling $1.9 billion.

The General Fund closing balance on September 30, 2003 was $2.56 billion. General Fund intra-month daily balances can be supplemented with positive balances in other governmental funds as permitted by legislation included in the 2003-04 Enacted Budget that allows the State Comptroller to temporarily access balances in other funds to support the General Fund within a month. This process was utilized in September, as planned, to ensure intra-month payments continued in a timely manner.

While the receipt of tobacco securitization proceeds and additional Federal aid has alleviated the tight monthly cash flow position experienced in the first six months of the 2003-04 State Fiscal Year, DOB continues to review cash balances on a daily basis and expects that cash flow in the early part of 2004-05 will have to be carefully monitored.

The 2003-04 General Fund cash flow is projected to end the third quarter with a balance of $2.54 billion, an increase of $1.07 billion over the prior fiscal year.

Debt Reform Act

The Debt Reform Act of 2000 imposed phased-in caps that limit new debt outstanding to four percent of personal income and new debt service costs to five percent of total governmental funds receipts. To immediately constrain State debt levels, the Act applies to all new State-supported debt issued on and after April 1, 2000 (excluding certain refunding bonds). Section 23 of the State Finance Law requires the calculation of the caps imposed by the Act to be submitted with the Financial Plan Update most proximate to October 31 of each year.

For the 2002-03 fiscal year, the debt outstanding and debt service caps are 1.65 percent each. As shown in the tables below, actual levels of debt outstanding and debt service costs continue to remain well below the limits imposed by the Act.

Debt Outstanding Cap ($ in millions)	
New Debt Outstanding	$8,295
Personal Income (CY 2002)	$684,070
Debt Outstanding (% of PI)	1.21%
Cap Imposed by Debt Reform Act	1.65%

Debt Service Cap ($ in millions)	
New Debt Service	$470
Governmental Funds Receipts	$90,174
Debt Service (% of Govn't Fund Receipts)	0.52%
Cap Imposed by Debt Reform Act	1.65%

CASH FINANCIAL PLAN
GENERAL FUND
2003-2004
(millions of dollars)

	July	Change	October
Opening fund balance	815	0	815
Receipts:			
Taxes:			
Personal income tax	16,284	(8)	16,276
User taxes and fees	7,975	(11)	7,964
Business taxes	3,436	0	3,436
Other taxes	711	15	726
Miscellaneous receipts	5,547	0	5,547
Federal grants	645	0	645
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	5,150	23	5,173
Sales tax in excess of LGAC debt service	1,960	0	1,960
Real estate taxes in excess of CW/CA debt service	199	11	210
All other	430	0	430
Total receipts	42,337	30	42,367
Disbursements:			
Grants to local governments	29,584	45	29,629
State operations	7,142	0	7,142
General State charges	3,258	0	3,258
Transfers to other funds:			
Debt service	1,541	0	1,541
Capital projects	255	0	255
State university	145	0	145
Other purposes	497	(15)	482
Total disbursements	42,422	30	42,452
Change in fund balance	(85)	0	(85)
Closing fund balance	730	0	730
Tax Stabilization Reserve Fund	710	0	710
Contingency Reserve Fund	20	0	20

CASH FINANCIAL PLAN
GENERAL FUND
2003-2004
(millions of dollars)

	Enacted	Change	October
Opening fund balance	815	0	815
Receipts:			
Taxes:			
Personal income tax	16,285	(9)	16,276
User taxes and fees	8,007	(43)	7,964
Business taxes	3,498	(62)	3,436
Other taxes	771	(45)	726
Miscellaneous receipts	5,569	(22)	5,547
Federal grants	0	645	645
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	5,125	48	5,173
Sales tax in excess of LGAC debt service	1,853	107	1,960
Real estate taxes in excess of CW/CA debt service	202	8	210
All other	430	0	430
Total receipts	41,740	627	42,367
Disbursements:			
Grants to local governments	29,835	(206)	29,629
State operations	7,205	(63)	7,142
General State charges	3,232	26	3,258
Transfers to other funds:			
Debt service	1,583	(42)	1,541
Capital projects	255	0	255
State university	145	0	145
Other purposes	482	0	482
Total disbursements	42,737	(285)	42,452
Fiscal Management Plan/Federal Aid	912	(912)	0
Change in fund balance	(85)	0	(85)
Closing fund balance	730	0	730
Tax Stabilization Reserve Fund	710	0	710
Contingency Reserve Fund	20	0	20

CASH FINANCIAL PLAN
GENERAL FUND
2002-2003 and 2003-2004
(millions of dollars)

	2002-2003 Actual	2003-2004 October	Annual Change
Opening fund balance	1,032	815	(217)
Receipts:			
Taxes:			
Personal income tax	16,791	16,276	(515)
User taxes and fees	7,063	7,964	901
Business taxes	3,380	3,436	56
Other taxes	743	726	(17)
Miscellaneous receipts	2,091	5,547	3,456
Federal grants	0	645	645
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	4,215	5,173	958
Sales tax in excess of LGAC debt service	1,919	1,960	41
Real estate taxes in excess of CW/CA debt service	263	210	(53)
All other	931	430	(501)
Total receipts	37,396	42,367	4,971
Disbursements:			
Grants to local governments	24,887	29,629	4,742
State operations	7,678	7,142	(536)
General State charges	2,699	3,258	559
Transfers to other funds:			
Debt service	1,496	1,541	45
Capital projects	166	255	89
State university	26	145	119
Other purposes	661	482	(179)
Total disbursements	37,613	42,452	4,839
Change in fund balance	(217)	(85)	132
Closing fund balance	815	730	(85)
Tax Stabilization Reserve Fund	710	710	0
Contingency Reserve Fund	20	20	0
Community Projects Fund	85	0	(85)

Note: Actuals reflect the amounts published in the Comptroller's Cash Basis Report released on July 29, 2003.

CURRENT STATE RECEIPTS
GENERAL FUND
2002-2003 and 2003-2004
(millions of dollars)

	2002-2003 Actual	2003-2004 October	Annual Change
Personal income tax	16,791	16,276	(515)
User taxes and fees:	7,063	7,964	901
Sales and use tax	6,328	7,250	922
Cigarette and tobacco taxes	446	415	(31)
Motor vehicle fees	67	75	8
Alcoholic beverages taxes	180	182	2
Alcoholic beverage control license fees	42	42	0
Business taxes:	3,380	3,436	56
Corporation franchise tax	1,407	1,388	(19)
Corporation and utilities tax	860	755	(105)
Insurance taxes	704	868	164
Bank tax	409	425	16
Other taxes:	743	726	(17)
Estate tax	701	692	(9)
Gift tax	7	0	(7)
Real property gains tax	5	2	(3)
Pari-mutuel taxes	29	32	3
Other taxes	1	0	(1)
Total taxes	27,977	28,402	425
Miscellaneous receipts	2,091	5,547	3,456
Federal grants	0	645	645
Total receipts	30,068	34,594	4,526

GENERAL FUND
PERSONAL INCOME TAX COMPONENTS
2002-2003 AND 2003-2004
(millions of dollars)

	2002-2003 Actual	2003-2004 October	Annual Change
Withholdings	19,959	22,085	2,126
Estimated Payments	4,855	5,035	180
Final Payments	1,334	1,240	(94)
Delinquencies	796	595	(201)
Gross Collections	26,944	28,955	2,011
State/City Offset	(288)	(300)	(12)
Refund Reserve	1,050	84	(966)
Refunds	(4,008) (1)	(4,230) (2)	(222)
Reported Tax Collections	23,698	24,509	811
STAR	(2,664)	(2,835)	(171)
RBTF	(4,243)	(5,398)	(1,155)
General Fund	16,791	16,276	(515)

Net personal income tax collections are affected by transactions in the tax refund reserve account. The tax refund reserve account is used to hold moneys designated to pay tax refunds. The Comptroller deposits receipts into this account at the discretion of the Commissioner of Taxation and Finance. The deposit of moneys into the account during a fiscal year has the effect of reducing receipts for the fiscal year, and the withdrawal of moneys from the account has the effect of increasing receipts in the fiscal year of withdrawal. The tax refund reserve account also includes amounts made available as a result of the LGAC financing program. Beginning in 1998-99, a portion of personal income tax collections is deposited directly in the School Tax Reduction (STAR) fund and used to make payments to reimburse local governments for their revenue decreases due to the STAR program.

Note 1: Reflects the payment of the balance of refunds on 2001 liability and payment of $960 million of calendar year 2002 refunds in the last quarter of the State's 2002-03 fiscal year and a balance in the Tax Refund Reserve Account of $627 million.

Note 2: Reflects the payment of the balance of refunds on 2002 liability and the projected payment of $960 million of calendar year 2003 refunds in the last quarter of the State's 2003-04 fiscal year and a projected balance in the Tax Refund Reserve Account of $543 million.

CASH FINANCIAL PLAN
STATE FUNDS
2003-2004
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	947	(560)	158	1,360
Receipts:					
Taxes	28,402	4,462	1,750	7,963	42,577
Miscellaneous receipts	5,547	9,943	3,232	702	19,424
Federal grants	645	1	0	0	646
Total receipts	34,594	14,406	4,982	8,665	62,647
Disbursements:					
Grants to local governments	29,629	10,237	1,095	0	40,961
State operations	7,142	4,630	0	8	11,780
General State charges	3,258	410	0	0	3,668
Debt service	0	0	0	3,387	3,387
Capital projects	0	6	3,062	0	3,068
Total disbursements	40,029	15,283	4,157	3,395	62,864
Other financing sources (uses):					
Transfers from other funds	7,773	820	280	4,882	13,755
Transfers to other funds	(2,423)	(229)	(947)	(10,149)	(13,748)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,350	591	(419)	(5,267)	255
Change in fund balance	(85)	(286)	406	3	38
Closing fund balance	730	661	(154)	161	1,398

The Special Revenue Funds Opening fund balance has been increased by $54 million to reflect the reclassification of the Expendable and Non-Expendable Trust Funds from the Fiduciary fund type to the Special Revenue fund type pursuant to GASB 34.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
2003-2004
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	1,039	(791)	158	1,221
Receipts:					
Taxes	28,402	4,462	1,750	7,963	42,577
Miscellaneous receipts	5,547	10,074	3,232	702	19,555
Federal grants	645	33,907	1,638	0	36,190
Total receipts	34,594	48,443	6,620	8,665	98,322
Disbursements:					
Grants to local governments	29,629	40,388	1,312	0	71,329
State operations	7,142	7,922	0	8	15,072
General State charges	3,258	576	0	0	3,834
Debt service	0	0	0	3,387	3,387
Capital projects	0	6	4,351	0	4,357
Total disbursements	40,029	48,892	5,663	3,395	97,979
Other financing sources (uses):					
Transfers from other funds	7,773	3,302	280	4,882	16,237
Transfers to other funds	(2,423)	(2,671)	(1,079)	(10,149)	(16,322)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,350	631	(551)	(5,267)	163
Change in fund balance	(85)	182	406	3	506
Closing fund balance	730	1,221	(385)	161	1,727

The Special Revenue Funds Opening fund balance has been increased by $54 million to reflect the reclassification of the Expendable and Non-Expendable Trust Funds from the Fiduciary fund type to the Special Revenue fund type pursuant to GASB 34.

CURRENT STATE RECEIPTS
ALL GOVERNMENTAL FUNDS
2002-2003 and 2003-2004
(millions of dollars)

	2002-2003 Actual	2003-2004 October	Annual Change
Personal income tax	23,698	24,509	811
User taxes and fees	10,804	11,906	1,102
Sales and use taxes	8,796	9,914	1,118
Cigarette and tobacco taxes	446	415	(31)
Motor fuel tax	544	515	(29)
Motor vehicle fees	612	651	39
Highway use tax	147	149	2
Alcoholic beverage taxes	180	182	2
Alcoholic beverage control license fees	42	42	0
Auto rental tax	37	38	1
Business taxes	4,983	5,021	38
Corporation franchise tax	1,612	1,577	(35)
Corporation and utilities taxes	1,091	964	(127)
Insurance taxes	776	972	196
Bank tax	481	497	16
Petroleum business taxes	1,023	1,011	(12)
Other taxes	1,191	1,141	(50)
Estate tax	701	691	(10)
Gift tax	7	0	(7)
Real property gains tax	5	2	(3)
Real estate transfer tax	448	415	(33)
Pari-mutuel taxes	29	32	3
Other taxes	1	1	0
Total taxes	40,676	42,577	1,901
Miscellaneous receipts	14,148	19,555	5,407
Federal grants	33,250	36,190	2,940
Total receipts	88,074	98,322	10,248

CASH FINANCIAL PLAN
SPECIAL REVENUE FUNDS
2003-2004
(millions of dollars)

	State	Federal	Total
Opening fund balance	947	92	1,039
Receipts:			
Taxes	4,462	0	4,462
Miscellaneous receipts	9,943	131	10,074
Federal grants	1	33,906	33,907
Total receipts	14,406	34,037	48,443
Disbursements:			
Grants to local governments	10,237	30,151	40,388
State operations	4,630	3,292	7,922
General State charges	410	166	576
Debt service	0	0	0
Capital projects	6	0	6
Total disbursements	15,283	33,609	48,892
Other financing sources (uses):			
Transfers from other funds	820	2,482	3,302
Transfers to other funds	(229)	(2,442)	(2,671)
Bond and note proceeds	0	0	0
Net other financing sources (uses)	591	40	631
Change in fund balance	(286)	468	182
Closing fund balance	661	560	1,221

The State Special Revenue Funds Opening fund balance has been increased by $54 million to reflect the reclassification of the Expendable and Non-Expendable Trust Funds from the Fiduciary fund type to the Special Revenue fund type pursuant to GASB 34.

CASH FINANCIAL PLAN
CAPITAL PROJECTS FUNDS
2003-2004
(millions of dollars)

	State	Federal	Total
Opening fund balance	(560)	(231)	(791)
Receipts:			
Taxes	1,750	0	1,750
Miscellaneous receipts	3,232	0	3,232
Federal grants	0	1,638	1,638
Total receipts	4,982	1,638	6,620
Disbursements:			
Grants to local governments	1,095	217	1,312
State operations	0	0	0
General State charges	0	0	0
Debt service	0	0	0
Capital projects	3,062	1,289	4,351
Total disbursements	4,157	1,506	5,663
Other financing sources (uses):			
Transfers from other funds	280	0	280
Transfers to other funds	(947)	(132)	(1,079)
Bond and note proceeds	248	0	248
Net other financing sources (uses)	(419)	(132)	(551)
Change in fund balance	406	0	406
Closing fund balance	(154)	(231)	(385)

CASHFLOW
GENERAL FUND
2003-2004
(millions of dollars)

	April	May	June	July	August	September	October	November	December
Opening fund balance	815	2,786	2,151	1,989	1,466	1,331	2,559	3,245	2,825
Receipts:									
Taxes									
Personal income tax	2,811	244	1,545	1,214	1,126	1,791	1,345	1,034	233
Sales tax	450	461	692	547	557	813	567	574	815
User taxes and fees	103	74	40	73	52	65	49	50	55
Business taxes	56	(133)	728	58	42	787	41	1	809
Other taxes	49	93	33	60	67	96	48	52	55
Tobacco bond proceeds	0	0	2,202	0	0	0	0	0	1,598
Federal Grants	0	0	323	0	0	0	323	0	0
Miscellaneous receipts	70	55	116	94	81	187	137	290	102
Transfers from other funds	898	297	770	585	561	816	628	460	359
Total receipts	4,437	1,091	6,449	2,631	2,486	4,555	3,138	2,461	4,026
Disbursements:									
Grants to local governments	1,462	604	5,426	1,834	1,723	1,703	1,557	1,871	2,973
State operations	743	799	648	845	606	634	504	656	728
General State charges	32	268	246	359	246	636	275	171	217
Transfers to other funds	229	55	291	116	46	354	116	183	397
Total disbursements	2,466	1,726	6,611	3,154	2,621	3,327	2,452	2,881	4,315
Change in fund balance	1,971	(635)	(162)	(523)	(135)	1,228	686	(420)	(289)
Closing fund balance	2,786	2,151	1,989	1,466	1,331	2,559	3,245	2,825	2,536

Note: Reflects actuals through September published in the Comptroller's Monthly Report on State Funds Cash Basis of Accounting for September 2003 and DOB projections for October through December.

GAAP-Basis Financial Plans

(Reprinted from August 7, 2003 Update to the AIS)

DOB also prepares the General Fund and All Governmental Funds Financial Plans in accordance with Generally Accepted Accounting Principles (GAAP). The GAAP results for 2002-03 and the projections for 2003-04 are based on the accounting principles applied by the State Comptroller in the financial statements issued for the 2002-03 State Fiscal Year, and reflect the impact of GASB 34. GASB 34 has significantly changed the presentation of GAAP financial information for State and local governments. The changes are intended to portray the State's net overall financial condition, including activities that affect State assets and liabilities during the fiscal year.

Based on the new GASB 34 presentation, the State has a net positive asset condition of $44.9 billion, a decrease of $5.5 billion from the prior year. In the General Fund, the State ended the 2002-03 fiscal year with an operating deficit of $4.22 billion. The operating result is primarily attributable to the use of $1.3 billion in cash reserves to balance the 2002-03 budget, a $1.0 billion decline in revenues as a result of the weak economy and lingering effects of the World Trade Center disaster, and the deferral of $1.9 billion in cash basis spending from 2002-03 until 2003-04. As a result of the operating deficit, the 2001-02 accumulated surplus (as restated) of $901 million has declined to a $3.32 billion accumulated deficit.

The General Fund is anticipated to end the 2003-04 fiscal year with an operating surplus of $968 million on a GAAP-basis which is primarily attributable to the receipt of the tobacco bond proceeds originally anticipated in 2002-03 but received in 2003-04, partially offset by the use of cash reserves and other non-recurring actions in 2003-04. As a result, the accumulated deficit is projected to improve to $2.25 billion by the end of the 2003-04 fiscal year.

Capital Program and Financing Plan Update

(Reprinted from August 7, 2003 Update to the AIS)

Section 22-c of the State Finance Law requires the Governor to update the five-year Capital Program and Financing Plan (the Plan) submitted with the Executive Budget by the later of July 30 or 90 days after the enactment of the State Budget. The updated 2003-04 through 2007-08 Capital Program and Financing Plan was released with the First Quarterly Update and can be obtained by contacting the Division of the Budget, State Capitol, Albany, NY 12224, (518) 473-8705, or by visiting its website at www.budget.state.ny.us.

Total capital spending is projected to be $26.2 billion across the five years of the Plan, an average of $5.2 billion annually. Transportation continues to be largest area of spending, which is projected at $15.3 billion over the five-year Plan. Spending for the environment ($4 billion), education ($2.2 billion), mental hygiene ($1.5 billion), public protection ($1.3 billion), and economic

development, housing and other programs ($1.9 billion) constitutes the remainder of the five-year Plan.

For 2003-04 through 2007-08, the Plan projects issuances of: $872 million in general obligation bonds; $5.3 billion in Dedicated Highway and Bridge Trust Fund Bonds issued by the Thruway Authority to finance capital projects for transportation; $955 million in Mental Health Facilities Improvement Revenue Bonds issued by DASNY to finance capital projects at mental health facilities; $276 million in SUNY Dormitory Facilities Revenue Bonds to finance capital projects related to student dormitories; and $7.9 billion in State Personal Income Tax Revenue Bonds to finance various capital programs including school construction, university facilities, SUNY community colleges, State court facilities, local highway improvements, prisons, housing, economic development and environmental programs, homeland security, and State facilities. The projections of State borrowings for the 2003-04 fiscal year are subject to change as market conditions, interest rates and other factors vary throughout the fiscal year.

The Debt Reform Act of 2000 has improved the State's borrowing practices by imposing phased-in caps on new debt outstanding and new debt service costs, limiting the use of debt to capital works and purposes only, and establishing a maximum term of 30 years on such debt. The Debt Reform Act applies to all new State-supported debt issued on and after April 1, 2000.

The most recent annual debt reform calculations show that the State was in compliance with both debt caps, with debt issued after March 31, 2000 and then outstanding at 0.67 percent of personal income and debt service on such debt at 0.36 percent of total governmental receipts as compared to the caps of 1.25 percent each. The State has also enacted statutory limits on the amount of variable rate obligations and interest rate exchange agreements that authorized issuers of State-supported debt may enter into. The statute limits the use of debt instruments which result in a variable rate exposure (e.g., variable rate obligations and interest rate exchange agreements) to no more than 15 percent of total outstanding State-supported debt, and limits the use of interest rate exchange agreements to a total notional amount of no more than 15 percent of total outstanding State-supported debt. All interest rate exchange agreements are subject to various statutory restrictions such as minimum counterparty ratings, monthly reporting requirements, and the adoption of interest rate exchange agreement guidelines. All the authorized issuers have adopted uniform guidelines as required by statute. As of March 31, 2003, there was approximately $1.9 billion in debt instruments resulting in a variable rate exposure. In addition, three authorized issuers entered into a total notional amount of $2.2 billion in interest rate exchange agreements, with a mark-to-market value of about $42 million. Both amounts are less than the authorized totals of 15 percent of total outstanding State-supported debt (about $5.8 billion each).

Special Considerations

The Financial Plan is necessarily based upon on forecasts of national and State economic activity. Economic forecasts have frequently failed to predict accurately the timing and magnitude of changes in the national and State economies. DOB believes that its current receipts and spending estimates related to the performance of the State and national economies are reasonable. However,

there can be no assurance that actual results will not differ materially and adversely from the current forecast.

Labor contracts between the State and most State employee unions expired on March 31, 2003 and collective bargaining negotiations are ongoing. The Financial Plan contains no reserves to finance potential new costs related to any new labor agreements. DOB projects that every one percent increase in salaries for all State employees would result in a General Fund Financial Plan cost of approximately $80 million.

DOB continues to forecast that the State's cash flow position will experience pressure in the first quarter of the 2004-05 fiscal year. A number of administrative options are available to DOB to manage General Fund cash flow needs during any fiscal year. The State is prohibited from issuing seasonal notes in the public credit markets to finance cash flow needs, unless the State satisfies certain restrictive conditions imposed under the LGAC statute and related bond covenants. For a discussion of the LGAC restrictions, see the section entitled "Debt and Other Financing Activities – Local Government Assistance Corporation" in the AIS.

On August 6, 2003, the LGAC board of directors, which is comprised of the LGAC chairperson, the State Comptroller, and the Director of DOB, unanimously approved a resolution objecting to the annual payments of $170 million to the City of New York and the refinancing of MAC bonds. The resolution directed LGAC to not participate in the New York City transaction, authorized the co-executive directors of LGAC to engage the services of litigation counsel, and declared that LGAC has no intention to pay such $170 million payments unless legal issues with the transaction (including but not limited to potential LGAC bond covenant violations) are resolved either by litigation or action by the Legislature. For an update on the status of this litigation, see the section entitled "Litigation" in this Update.

The Federal government is currently auditing Medicaid claims submitted since 1993 under the school supportive health services program. At this point, these audits have not been finalized, and, as a result, the liability of the State and/or school districts for any disallowances that may result from these audits cannot be determined. Federal regulations include an appeals process that could postpone repayment of any disallowances.

In addition, as of September 2003, nearly $300 million in Federal Medicaid payments related to school supportive health services have been deferred by the Federal Centers for Medicare and Medicaid Services. Since the State has continued to reimburse school districts for these costs, these Federal deferrals, if not resolved, could result in a Medicaid cash shortfall, potentially creating a need for additional State support in the short-term.

New York State continues to await Federal approval of the Medicaid State Plan Amendment necessary to make planned payments totaling roughly $1.1 billion (half funded by the Federal government) to public hospitals throughout the State, including New York City Health and Hospitals Corporation, State University of New York hospitals, and other State and county operated facilities.

The current State Financial Plan assumes no significant Federal disallowances or other Federal actions that could adversely affect State finances. As a result, there can be no assurance that the State's budget projections for 2003-04 will not differ materially and adversely from the projections set forth at this time.

PART II

Part II of this Update contains reprinted information on GAAP-basis results for fiscal year 2002-03 that appeared in the August 7, 2003 Update to the AIS. It also contains updated disclosure on the State Retirement System, the Metropolitan Transportation Authority, and the City of New York.

GAAP-Basis Results for Prior Fiscal Years

(Reprinted from August 7, 2003 Update to the AIS)

On July 29, 2003, the State Comptroller issued the Basic Financial Statements and Other Supplementary Information (the 2002-03 Basic Financial Statements) for the 2002-03 fiscal year. The 2002-03 Basic Financial Statements were prepared in accordance with GASB 34 and other applicable GASB statements. The 2002-03 Basic Financial Statements can be obtained by visiting the Office of the State Comptroller's website, www.osc.state.ny.us, or by contacting the Office of the State Comptroller, 110 State Street, Albany, NY 12236.

For a brief summary of the 2002-03 GAAP-basis results, see the section entitled "GAAP-basis Financial Plans" in Part I of this Update.

State Organization

State Retirement Systems

General

The New York State and Local Retirement Systems (the "Systems") provide coverage for public employees of the State and its localities (except employees of New York City and teachers, who are covered by separate plans). The Systems comprise the New York State and Local Employees Retirement System and the New York State and Local Police and Fire Retirement System. The Comptroller is the administrative head of the Systems. State employees made up about 34 percent of the membership during the 2002-03 fiscal year. There were 2,818 other public employers participating in the Systems, including all cities and counties (except New York City), most towns, villages and school districts (with respect to non-teaching employees) and a large number of local authorities of the State.

As of March 31, 2003, 650,543 persons were members and 313,597 pensioners or beneficiaries were receiving benefits. The State Constitution considers membership in any State pension or retirement system to be a contractual relationship, the benefits of which shall not be diminished or impaired. Members cannot be required to begin making contributions or make increased contributions beyond what was required when membership began.

Contributions

Funding is provided in large part by employer and employee contributions. Employers contribute on the basis of the plan or plans they provide for members. Members joining since mid-1976, other than police and fire members, are required to contribute 3 percent of their salaries for their first 10 years of membership.

Legislation enacted in May, 2003 realigns the Retirement Systems billing cycle to match governments' budget cycles and the legislation also institutes a minimum annual payment. The employer contribution for a given fiscal year will be based on the value of the pension fund and its liabilities on the prior April 1. In addition, employers will be required to make a minimum contribution of at least 4.5 percent of payroll every year. The legislation also eliminates the State's ability to delay payments when the amounts owed are greater than the amount budgeted, effective in fiscal year 2004-2005. Also, a portion of the 2004-2005 bill may be amortized over a five-year period at 8 percent interest with the first payment due in 2004-05.

Due to the enactment of this legislation, the State bill due in the fiscal year ending March 31, 2004**,** payable September 1, 2003, was $481.5 million, of which $396.3 million was paid. The difference with 8 percent interest will be due on or before March 1, 2006. Employer contributions due from the State for the fiscal year ending March 31, 2005, payable September 1, 2004, are estimated at $1.15 billion or $797 million if the maximum amount is amortized.

Assets and Liabilities

Assets are held exclusively for the benefit of members, pensioners and beneficiaries. Investments for the Systems are made by the Comptroller as trustee of the Common Retirement Fund, a pooled investment vehicle. OSC reports the net assets available for benefits as of March 31, 2003 were $97.4 billion (including $2.3 billion in receivables), a decline of $15.3 billion or 13.6 percent from the 2001-02 level of $112.7 billion, reflecting, in large part, equity market performance. OSC reports that the present value of anticipated benefits for current members, retirees, and beneficiaries as of March 31, 2003 was $130.5 billion (including $46.1 billion for current retirees and beneficiaries), an increase of $3.5 billion or 2.8 percent from the 2001-02 level of $127 billion. The funding method used by the Systems anticipates that the net assets, plus future actuarially determined contributions, will be sufficient to pay for the anticipated benefits of current members, retirees and beneficiaries. Actuarially determined contributions are calculated using actuarial assets and the present value of anticipated benefits. Actuarial assets differ from net assets in that they are calculated using a five-year smoothing method for valuing equity investments and using amortized cost instead of market value for bonds and mortgages. Actuarial assets decreased from $125.2 billion in 2002 to $106.7 billion on March 31, 2003. The table below shows the actuarially determined contributions that have been made over the last six years. See also "Contributions" above.

Net Assets Available for Benefits of the
New York State and Local Retirement Systems(1)
(millions of dollars)

Fiscal Year Ended March 31	Total Assets(2)	Increase/ (Decrease) From Prior Year
1998	106,319	26.7
1999	112,723	6.0
2000	128,889	14.3
2001	114,044	(11.5)
2002	112,725	(1.2)
2003	97,373	(13.6)

(1) Includes relatively small amounts held under Group Life Insurance Plan. Includes some employer contribution receivables. Fiscal year ending March 31, 2003 includes approximately $2.3 billion of receivables.
(2) Includes certain accrued employer contributions to be paid with respect to service rendered during fiscal years other than the year shown.

Contributions and Benefits
New York State and Local Retirement Systems
(millions of dollars)

Ended March 31	All Participating Employers(1)	Local Employers(1)	State(1)	Employees	Benefits Paid(2)
1998	463	358	105	369	3,395
1999	292	156	136	400	3,570
2000	165	11	154	423	3,787
2001	215	112	103	319	4,267
2002	264	199	65	210	4,576
2003	652	378	274	219	5,030

Sources: State and Local Retirement Systems.
(1) Includes employer premiums to Group Life Insurance Plan.
(2) Includes payments from Group Life Insurance Plan.

Authorities and Localities

Metropolitan Transportation Authority

The following information was prepared from information furnished by the Metropolitan Transportation Authority (MTA) and is provided for informational purposes only. This section is intended to provide readers with a brief summary of State oversight and financial assistance to the MTA. The official financial disclosure of the MTA and its subsidiaries is available by contacting the Metropolitan Transportation Authority, Finance Department, 347 Madison Avenue, 6th Floor, New York, New York 10017 or by visiting the MTA website at www.mta.info/mta/investor.htm. The State assumes no liability or responsibility for any financial information reported by the MTA or for any errors or omissions that may be contained at the MTA website.

The MTA oversees the operation of subway and bus lines in New York City by its affiliates, the New York City Transit Authority and the Manhattan and Bronx Surface Transit Operating Authority (collectively, the TA). The MTA operates certain commuter rail and bus services in the New York metropolitan area through the MTA's subsidiaries, the Long Island Rail Road Company, the Metro North Commuter Railroad Company, and the Metropolitan Suburban Bus Authority. In addition, the Staten Island Rapid Transit Operating Authority, an MTA subsidiary, operates a rapid transit line on Staten Island. Through its affiliated agency, the Triborough Bridge and Tunnel Authority (TBTA), the MTA operates certain intrastate toll bridges and tunnels. Because fare revenues are not sufficient to finance the mass transit portion of these operations, the MTA has depended on, and will continue to depend on, operating support from the State, local governments and TBTA, including loans, grants and subsidies. If current revenue projections are not realized and/or operating expenses exceed current projections, the MTA may be required to seek additional State assistance, raise fares or take other actions.

The MTA Board has approved a financial plan for the years 2003 and 2004 for itself and its affiliates and subsidiaries (the 2003-04 Financial Plan) that will enable all such entities to maintain their respective operations on a self-sustaining basis through 2004. The 2003-04 Financial Plan tracks the final two years of the 2000-2004 Capital Programs of the transit and commuter systems (the 2000-2004 Capital Programs) that were approved by the Capital Program Review Board. As part of the 2003-04 Financial Plan, fares on the transit and commuter systems and tolls on TBTA's bridges and tunnels were increased in May 2003. Legal challenges to the fare and toll increases were unsuccessful.

On October 28, 2003 the MTA released a revised 2003 budget and a four-year Financial Plan for itself and its affiliates and subsidiaries for 2004 - 2007. This Plan expects balanced budgets for 2003 and 2004. The Plan anticipates budget gaps of $840 million in 2005, $1.34 billion in 2006 and $1.45 billion in 2007. The MTA will solicit wide-ranging comment from the public and elected officials and submit a revised final 2004 budget and 2005 - 2007 Financial Plan to its Board in late December 2003.

On May 4, 2000, the Capital Program Review Board approved the MTA's $17.1 billion 2000-2004 Capital Programs. Other amendments were subsequently approved raising the total of the programs to $17.9 billion. The 2000-2004 Capital Programs are the fifth approved capital plan since the Legislature authorized procedures for the adoption, approval and amendment of MTA capital programs and is designed to upgrade the performance of the MTA's transportation systems by investing in new rolling stock, maintaining replacement schedules for existing assets, bringing the MTA system into a state of good repair, and making major investments in system expansion projects such as the Second Avenue Subway project and the East Side Access project. The 2000-2004 Capital Programs approved by the Capital Program Review Board assume the issuance of an estimated $10.6 billion in new money MTA bonds. The remainder of the plan is projected to be financed with assistance from the Federal government, the State, The City of New York, and from various other revenues generated from actions taken by the MTA.

Since 1980, the State has enacted several taxes including a surcharge on the profits of banks, insurance corporations and general business corporations doing business in the 12-county Metropolitan Transportation Region served by the MTA and a special one-quarter of one percent regional sales and use tax that provide revenues for mass transit purposes, including assistance to the MTA. Since 1987, State law also has required that the proceeds of a one-quarter of one percent mortgage recording tax paid on certain mortgages in the Metropolitan Transportation Region be deposited in a special MTA fund for operating or capital expenses. In 1993, the State dedicated a portion of certain additional petroleum business tax receipts to fund operating or capital assistance to the MTA. The 2000-01 Enacted Budget initiated a five-year State transportation plan that included nearly $2.2 billion in dedicated revenue support for the MTA's 2000-2004 Capital Programs. This capital commitment includes approximately $800 million of newly dedicated State petroleum business tax revenues, motor vehicle fees, and motor fuel taxes not previously dedicated to the MTA. State legislation accompanying the 2000-01 Enacted Budget increased the aggregate bond cap for the MTA, TBTA and TA to $16.5 billion in order to finance a portion of the 2000-2004 Capital Programs.

There can be no assurance that all the necessary governmental actions for the current or future capital programs will be taken or that funding sources currently identified will not be decreased or eliminated. As appropriate, the MTA and the Capital Program Review Board may amend the 2000-2004 Capital Programs from time to time to reflect the level of funding available to pay for the capital projects anticipated to be undertaken during the time period covered by the approved programs. If the 2000-2004 Capital Programs are delayed or reduced, ridership and fare revenue may decline, which could impair the MTA's ability to meet its operating expenses without additional State assistance.

The City of New York

The following information was prepared from information furnished by The City of New York and is provided for informational purposes only. This section is intended to provide readers with a brief summary of the financial condition of The City of New York, which is the largest municipal recipient of State assistance to local governments. The fiscal demands on the State may be affected

by the fiscal condition of the City, which relies in part on State aid to balance its budget and meet its cash requirements. It is also possible that the State's finances may be affected by the ability of the City, and certain entities issuing debt for the benefit of the City, to market securities successfully in the public credit markets. The official financial disclosure of The City of New York and financing entities issuing debt on its behalf is available by contacting Raymond J. Orlando, Director of Investor Relations, or contacting the New York City Office of Management and Budget, 75 Park Place, 6th Floor, New York, NY 10007, (212) 788-5875. The State assumes no liability or responsibility for any financial information reported by The City of New York.

On June 30, 2003, the City submitted to the State Financial Control Board (the "Control Board") the Financial Plan for the 2003 through 2007 fiscal years, which relates to the City and certain entities which receive funds from the City, and which reflects changes as a result of the City's expense and capital budgets for the 2004 fiscal year which were adopted on June 27, 2003. The Financial Plan is a modification to the financial plans submitted to the Control Board on November 18, 2002, January 31, 2003 and April 23, 2003. The Financial Plan projects revenues and expenditures for the 2003 and 2004 fiscal years balanced in accordance with GAAP, and projects gaps of $2.0 billion, $3.2 billion, and $3.3 billion for fiscal years 2005, 2006, and 2007, respectively.

The current Financial Plan reflects changes since the June Financial Plan which decreased projected revenues, by $821 million, $2.3 billion, $2.2 billion and $2.0 billion in fiscal years 2003 through 2006, respectively, and increased projected net expenditures by $1.3 billion, $1.3 billion and $1.6 billion in fiscal years 2004 through 2006, respectively. Changes in projected revenues include a decline in projected tax revenues of $621 million, $1.6 billion, $1.8 billion and $1.9 billion in fiscal years 2003 through 2006, respectively, reflecting primarily decreases in projected personal income, business and sales tax revenues, as well as the elimination of previously assumed non-tax revenues. The decline in projected tax revenue growth reflects the September 11th attack and a continued weak economy, which has resulted in lower wage earnings, lower corporate earnings, local job losses exceeding 117,000 in 2002 and 20,000 in the first half of 2003, a disruption in tourism and related spending and the decline in financial services sector profits and employee income. Changes in projected expenditures since the June Financial Plan include: (i) increased pension costs totaling $213 million, $369 million and $541 million for fiscal years 2004 through 2006, respectively, resulting primarily from additional pension benefits and investments losses in fiscal year 2002, partially offset by projected investment gains in fiscal year 2003; and (ii) the elimination of $223 million, $296 million, $291 million and $412 million of previously assumed labor productivity initiatives in fiscal years 2003 through 2006, respectively. In addition, the City will receive $232 million over the next five years generated by the Battery Park City Authority's (BPCA) recent bond refunding. Of this amount, the City will receive $68 million in fiscal year 2004, which is in addition to the $150 million reflected in the City's Financial Plan from the sale of City-owned land to BPCA. Changes in projected expenditures also include increased agency spending, increased costs for settling claims against the City, increased health and welfare spending primarily for Medicaid, increased debt service costs, an increase in the labor reserve and funding for capital expenditures. The Financial Plan also includes proposed discretionary transfers and prepayments in fiscal year 2003 of $1.3 billion, reflecting discretionary transfers and prepayments in fiscal year 2003 of $679

million in debt service, subsidies and lease debt service due in fiscal year 2004 and a miscellaneous budget grant of $624 million to the Transitional Finance Authority in fiscal year 2003, which increases tax revenue in fiscal year 2004 by $624 million.

The gap-closing program included in the Financial Plan reflects: (i) the enacted 18.49 percent property tax increase, effective January 1, 2003, which is projected to continue to generate $837 million, $1.7 billion, $1.8 billion and $1.9 billion in fiscal years 2003 through 2006, respectively, and (ii) a gap-closing program to reduce agency expenditures (including debt service savings reflecting a 24 percent reduction in capital commitments) and increase agency revenues by $950 million in fiscal year 2003 and by between $2.1 billion and $2.2 billion annually in subsequent fiscal years.

The gap-closing program included in the Financial Plan also reflects: (i) an enacted increase in the personal income tax rates (which decline after the first year) for City residents with taxable income above specified amounts for three years, commencing January 1, 2003, which is projected to generate $644 million, $545 million and $315 million in fiscal years 2004 through 2006, respectively; (ii) an enacted increase in the City portion of the sales tax by one-eighth percent for two years, commencing in June 2003, which is proposed to generate $115 million and $111 million in fiscal years 2004 and 2005, respectively; (iii) the repeal, beginning June 1, 2003, of the sales tax exemption on the purchase of clothing and footwear under $110 for one year with two one-week periods of exemption which is expected to generate $192 million in fiscal year 2004; (iv) legislation enacted by the State Legislature pursuant to which LGAC is to make available to the City $170 million annually which the City intends to assign to a newly-created financing entity for the purpose of refinancing outstanding indebtedness of the Municipal Assistance Corporation for the City of New York (MAC) which would make available to the City approximately $500 million annually in fiscal years 2004 through 2008 by reducing the amount of City revenues retained for MAC debt service; (v) $200 million, $583 million and $96 million in fiscal years 2004 through 2006, respectively, of back rent and renegotiated future lease payments for the City's airports, which is subject to the settlement of the City's claim for back rent and the renegotiation of the City's airport leases; and (vi) additional Federal assistance and additional State assistance which requires the approval of the State government. Additional Federal gap-closing actions in the Financial Plan include $420 million in fiscal year 2003 (in addition to the $230 million previously provided) to reimburse the City for costs related to the September 11th attack and increased Federal funding for Medicaid which is expected to generate approximately $290 million for the City over the fifteen months ending June 30, 2004. The additional State actions proposed in the Financial Plan include a proposed regional transportation initiative which would produce savings for the City totaling $75 million in fiscal year 2004 and approximately $150 million annually in each of fiscal years 2005 and 2006 by transferring responsibility for the local private bus system to the Metropolitan Transportation Authority. Subsequent to the passage of the State budget by the State Legislature, the Governor vetoed significant portions of the budget and other legislation providing City assistance, including legislation relating to the increase in the in the City personal income tax and the sales tax, the proposed $170 million annual payment by LGAC that the City intends to use to pay for MAC debt and the restoration of State education aid. In his veto message, the Governor raised questions as

to the constitutionality of the mandated annual $170 million payment. On May 15 and May 19, 2003, the State Legislature overrode the Governor's vetoes. On August 6, 2003 the LGAC directors adopted a resolution stating that LGAC would not make the $170 million annual payment to the City, expressing legal and policy concerns with the legislation.

On August 13, 2003, LGAC, its Chairperson, the State Division of the Budget and its Director sued the City and the Sales Tax Asset Receivable Corporation (STAR Corp.) seeking to prevent the issuance of bonds by STAR Corp., the local development corporation expected to finance the cost of debt service on MAC debt otherwise payable from City sales tax revenues. STAR Corp. debt is expected to be paid from the annual payment of $170 million from LGAC which the City would assign to STAR Corp. The State Supreme Court granted the City's and STAR Corp.'s motion for summary judgment. Plaintiffs appealed that decision to the State Appellate Division which had previously issued a preliminary injunction preventing STAR Corp. from issuing its bonds pending appeal. The appeal is expected to be heard in November. The outcome of this litigation cannot be predicted with certainty. If the $500 million in annual savings in MAC debt service for fiscal years 2004 through 2008 from the STAR Corp. financing is not available to the City, the City would be forced to reduce expenditures or increase revenues to maintain balanced operating results for fiscal year 2004 and would be faced with larger than forecast budget gaps in the subsequent years of the Financial Plan.

The Financial Plan does not make any provision for wage increases, other than the pay increases for the 2000-2002 round of bargaining and pay increases to be funded by productivity initiatives. It is estimated that each one percent wage increase for all City employees for subsequent contract periods would cost approximately $212 million annually (including benefits). The City Comptroller and others have issued reports identifying various risks. In addition, the economic and financial condition of the City may be affected by various financial, social, economic, geo-political and other factors which could have a material effect on the City.

On October 3, 2003, the City's Office of Management and Budget directed City agencies to detail how they would sustain a three percent reduction in City-funded expenditures, with the goal of achieving budgetary savings of $300 million in fiscal year 2004.

On October 15, 2003, the Mayor and the Governor announced that the City and the Port Authority of New York and New Jersey (the "Port Authority") had reached an agreement to extend the current lease on John F. Kennedy International and LaGuardia airports through 2050. The agreement secures a minimum upfront payment to the City of approximately $700 million and a minimum annual rent payment of $93.5 million. The upfront payment, which consists of an approximately $500 million lump sum payment and the annual rent payments for 2002 and 2003, is expected to be received late in fiscal year 2004 or in fiscal year 2005. This agreement is subject to the approval of the Port Authority Board and other closing conditions.

Monitoring Agencies

On July 30, 2003, the City Comptroller released a report on the Financial Plan that identified risks for the fiscal years 2004 through 2007, respectively, which, when added to the gaps in the Financial Plan, result in gaps of $484 million, $3.0 billion, $3.9 billion and $3.9 billion in fiscal years 2004 through 2007, respectively.

On July 24, 2003, the Office of the State Deputy Comptroller issued a report on the Financial Plan that identified net risks of $367 million, $806 million, $401 million and $423 million for fiscal years 2004 through 2007, respectively.

On July 24, 2003, the staff of the Control Board issued a report reviewing the Financial Plan that identified net risks of $154 million, $775 million, $291 million and $313 million for fiscal years 2004 through 2007, respectively, which, when combined with the gaps projected in the Financial Plan, result in estimated gaps of $154 million, $2.8 billion, $3.5 billion and $3.6 billion for fiscal years 2004 through 2007, respectively.

The staffs of the FCB, OSDC, the City Comptroller and the Independent Budget Office, issue periodic reports on the City's financial plans. Copies of the most recent reports are available by contacting: FCB, 123 William Street, 23rd Floor, New York, NY 10038, Attention: Executive Director; Independent Budget Officer, OSDC, 59 Maiden Lane, 29th Floor, New York, NY 10038, Attention: Deputy Comptroller; City Comptroller, Municipal Building, 6th Floor, One Centre Street, New York, NY 10007-2341, Attention: Deputy Comptroller for Budget; and IBO, 110 William Street, 14th Floor, New York, NY 10038, Attention: Director.

PART III

Litigation

Local Government Assistance Corporation

In *Local Government Assistance Corporation et al. v. Sales Tax Asset Receivable Corporation and The City of New York* (Supreme Court, Albany County), the petitioners challenge, inter alia, the constitutionality of Public Authorities Law section 3238-a, which requires LGAC to annually transfer $170 million to The City of New York. Section 3238-a was enacted in 2003 as part of legislation (Part A4 of Chapter 62 and Part V of Chapter 63 of the Laws of 2003) authorizing the refinancing of debt incurred by the Municipal Assistance Corporation (the MAC Refinancing Act). By decision and order dated September 17, 2003, the court held that the MAC Refinancing Act was constitutional. Petitioners have appealed from the decision and order to the Appellate Division, Third Department. By decision and order entered August 27, 2003, the Appellate Division, Third Department granted a preliminary injunction restraining defendants, inter alia, from issuing any bonds pursuant to the MAC Refinancing Act pending appeal.

School Aid

In *Campaign for Fiscal Equity, Inc. et al. v. State, et al.* (Supreme Court, New York County), plaintiffs challenge the State's method of providing funding for New York City public schools. Plaintiffs seek a declaratory judgment that the State's public school financing system violates article 11, section 1 of the State Constitution and Title VI of the Federal Civil Rights Act of 1964 and injunctive relief that would require the State to satisfy State Constitutional standards.

This action was commenced in 1993. In 1995, the Court of Appeals affirmed the dismissal of claims under the equal protection clauses of the Federal and State constitutions and Title VI of the Federal Civil Rights Act of 1964. It reversed dismissal of the claims under article 11, section 1 of the State Constitution and implementing regulations of Title VI, and remanded these claims for trial.

By decision dated January 9, 2001, following trial, the trial court held that the State's education funding mechanism does not provide New York City students with a "sound basic education" as required by the State Constitution, and that it has a disparate impact on plaintiffs in violation of regulations enacted by the U.S. Department of Education pursuant to Title VI of the Civil Rights Act of 1964. The court ordered that defendants put in place reforms of school financing and governance designed to redress those constitutional and regulatory violations, but did not specify the manner in which defendants were to implement these reforms. The State appealed, and the trial court's decision was stayed pending resolution of the appeal. By decision and order entered June 25, 2002, the Appellate Division, First Department, reversed the January 9, 2001 decision and dismissed the claim in its entirety. On July 22, 2002, the plaintiffs filed a notice of appeal to the decision and order to the Court of Appeals.

By decision dated June 26, 2003, the Court of Appeals reversed that portion of the June 25, 2002 decision and order of the Appellate Division, First Department relating to the claims arising

under the State Constitution. The Court held that the weight of the credible evidence supported the trial court's conclusion that New York City schoolchildren were not receiving the constitutionally mandated opportunity for a sound basic education and further held that the plaintiffs had established a causal link between the present education funding system and the failure to provide said sound basic education. The Court remitted the case to the trial court for further proceedings in accordance with its decision.

Medicaid

Several cases challenge provisions of Chapter 81 of the Laws of 1995 which alter the nursing home Medicaid reimbursement methodology on and after April 1, 1995. Included are *New York State Health Facilities Association, et al., v. DeBuono, et al., St. Luke's Nursing Center, et al. v. DeBuono, et al., New York Association of Homes and Services for the Aging v. DeBuono, et al. (three cases), Healthcare Association of New York State v. DeBuono and Bayberry Nursing Home et al. v. Pataki, et al*. Plaintiffs allege that the changes in methodology have been adopted in violation of procedural and substantive requirements of State and Federal law.

In a decision dated June 3, 2003, involving seven consolidated cases (*Matter of St. James Nursing Home v. DeBuono*), the Supreme Court, Albany County, partially granted petitioners claims that the State violated the procedural requirements of the Boren Amendment and directed the State to recalculate the Medicaid rates associated with State Plan Amendment 95-23. The court dismissed petitioners' claims as to the Medicaid rates associated with State Plan Amendments 95-24 and 96-24. The State has appealed from this decision.

In related cases, *New York Association of Homes and Services for the Aging, Inc. v. Novello, et al., Valley Health Services v. State and Charles T. Sitrin Health Care Center, Inc., et al. v. SONY, et al.,* plaintiffs seek judgments declaring as unconstitutional, under provisions of the Constitutions of the United States and the State, amendments to Public Health Law § 2907-d, enacted as part of Chapter 1 of the Laws of 2002, also known as the Health Care Workforce Recruitment & Retention Act of 2002, or "HCRA 2002," which impose a 6 percent assessment on nursing home gross receipts from patient care services and operating income. In a decision dated April 24, 2003, the Court granted summary judgment to defendants dismissing the *Sitrin* case. Plaintiffs have appealed from this decision.

Empire Conversion

In *Consumers Union of U.S., Inc. v. State*, plaintiffs challenge the constitutionality of those portions of Chapter 1 of the Laws of 2002 which relate to the authorization of the conversion of Empire Health Choice, d/b/a Empire Blue Cross and Blue Shield from a not-for-profit corporation to a for-profit corporation. Chapter 1 requires, in part, that upon such conversion, assets representing 95 percent of the fair market value of the not-for-profit corporation be transferred to a fund designated as the "public asset fund" to be used for the purpose set forth in § 7317 of the Insurance Law. The State and private defendants have separately moved to dismiss the complaint. On November 6, 2002, the Supreme Court, New York County, granted a temporary restraining order,

directing that the proceeds from the initial public offering of the for-profit corporation be deposited with the State Comptroller in an interest-bearing account, pending the hearing of a motion for a preliminary injunction, which was returnable simultaneously with the motions to dismiss, on November 26, 2002.

By decision dated February 28, 2003, the Supreme Court, New York County, granted the defendants' motions to dismiss. In its decision, the court also granted plaintiffs leave to amend their complaint to assert a new cause of action and deferred decision on plaintiffs' motion for a preliminary injunction. The plaintiffs and defendants have appealed from the February 28, 2003 decision. Plaintiffs served an amended complaint on April 1, 2003. On April 15, 2003, the defendants moved to dismiss the amended complaint. By decision dated October 1, 2003, the court denied defendants' motions to dismiss, except for the motions to dismiss brought by the individually named members of the board of directors of Empire Healthchoice, Inc. The court also declined to vacate the temporary restraining order directing that the proceeds from the initial public offering of the for-profit corporation be deposited with the State Comptroller in an interest-bearing account. Defendants intend to appeal this decision.

Real Property Claims

In the *Canadian St. Regis Band of Mohawk Indians* case, plaintiffs seek ejectment and monetary damages with respect to their claim that approximately 15,000 acres in Franklin and St. Lawrence Counties were illegally transferred from their predecessors-in-interest. By decision dated July 28, 2003, the District Court granted, in most respects, a motion by plaintiffs to strike defenses and dismiss counterclaims contained in defendants' answers. By decision dated October 20, 2003, the District Court denied the States motion for reconsideration of that portion of the July 28, 2003 decision which struck a counterclaim against the United States for contribution.

In the *Cayuga Indian Nation of New York* case, plaintiffs seek monetary damages for their claim that approximately 64,000 acres in Seneca and Cayuga Counties were illegally purchased by the State in 1795. Prior to trial, the court held that plaintiffs were not entitled to seek the remedy of ejectment. In October 1999, the District Court granted the Federal government's motion to have the State held liable for any damages owed to the plaintiffs. In February 2000, at the conclusion of the damages phase of the trial of this case, a jury verdict of $35 million in damages plus $1.9 million representing the fair rental value of the tract at issue was rendered against the defendants. By decision and judgment dated October 2, 2001, the District Court also granted plaintiffs $211 million in prejudgment interest. The State has appealed from the judgment to the United States Court of Appeals for the Second Circuit. On October 1, 2003, the State served the United States Department of the Interior and the United States Department of Justice with a statement of claim asserting that the United States is jointly and severally liable with the State for the $248 million judgment and post-judgment interest. A statement of claim is a precursor to filing a proceeding in the United States Court of Claims.

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Annual Information Statement
State of New York
Dated: May 30, 2003

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Annual Information Statement of the State of New York

Introduction

This Annual Information Statement ("AIS") is dated May 30, 2003 and contains information only through that date. This AIS constitutes the official disclosure information regarding the financial condition of the State of New York (the "State"). This AIS, including the Exhibits attached hereto, should be read in its entirety, together with any update or supplement issued during the fiscal year.

In this AIS, readers will find:

1. A section entitled the "Current Fiscal Year" that contains (a) the Enacted Budget Financial Plan prepared by the Division of the Budget ("DOB"), including the State's official Financial Plan projections and (b) a discussion of potential risks that may affect the State's Financial Plan during the current fiscal year under the heading "Special Considerations."

2. Information on other subjects relevant to the State's fiscal condition, including: (a) operating results for the three prior fiscal years, (b) the State's revised economic forecast and a profile of the State economy, (c) debt and other financing activities, (d) governmental organization, and (e) activities of public authorities and localities.

3. The status of significant litigation that has the potential to adversely affect the State's finances.

DOB is responsible for organizing and presenting the information that appears in this AIS on behalf of the State. In preparing the AIS, DOB relies on information drawn from several sources, including the Office of the State Comptroller ("OSC"), public authorities, and other sources believed to be reliable, but its presentation herein has not been subject to an independent audit process by DOB. Information relating to matters described in the section entitled "Litigation" is furnished by the Office of the State Attorney General.

During the fiscal year, the Governor, the State Comptroller, State legislators, and others may issue statements or reports that contain predictions, projections or other information relating to the State's financial condition, including potential operating results for the current fiscal year and projected baseline gaps for future fiscal years, that may vary materially from the information provided in this AIS. Investors and other market participants should, however, refer to this AIS, as revised, updated, or supplemented, for official information regarding the financial condition of the State.

The State plans to issue updates to this AIS on a quarterly basis (generally in July, November and January of each fiscal year) and may issue supplements or other disclosure notices as events warrant. The State intends to announce publicly whenever an update or a supplement is issued. The State may choose to incorporate by reference all or a portion of this AIS in Official Statements or related disclosure documents for State or State-supported debt issuance. Readers may obtain informational copies of the AIS, updates, and supplements by contacting Mr. Louis Raffaele, Chief Budget Examiner, New York State Division of the Budget, State Capitol, Albany, NY 12224, (518) 473-8705. This AIS has also been filed with the Nationally Recognized Municipal Securities Information Repositories. The Basic Financial

Statements for the 2002-03 fiscal year are expected to be available in July 2003 and may be obtained from the Office of the State Comptroller, 110 State Street, Albany, NY 12236.

Informational copies of this AIS are available electronically on the DOB website at www.budget.state.ny.us. Typographical or other errors may have occurred in converting the original source documents to their digital format, and DOB assumes no liability or responsibility for errors or omissions contained at the Internet site.

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Current Fiscal Year

The State's current fiscal year began on April 1, 2003 and ends on March 31, 2004. On March 31, 2003, the State Legislature enacted appropriations for all State-supported, contingent contractual, and certain other debt service obligations for the entire 2003-04 fiscal year. On May 2, 2003, the Legislature completed action on the remaining appropriations and accompanying legislation constituting the budget for the 2003-04 fiscal year. The Governor vetoed substantial portions of the budget revisions enacted by the Legislature, but the Legislature overrode the vetoes on May 15, 2003. Accordingly, DOB issued the Enacted Budget Financial Plan on May 28, 2003 that reflected final action on the 2003-04 State Budget by the Legislature.

The Enacted Budget Financial Plan set forth below was prepared by the DOB and reflects actions by the State Legislature through the date of this AIS. The Enacted Budget Financial Plan contains estimates and projections of future results that should not be construed as statements of fact. These estimates and projections are based upon various assumptions that may be affected by numerous factors, including future economic conditions in the State and nation and potential litigation concerning actions by the State Legislature in enacting the 2003-04 budget. There can be no assurance that actual results will not differ materially and adversely from the estimates and projections contained in the Enacted Budget Financial Plan.

Enacted Budget Financial Plan

Overview

The 2003-04 Executive Budget reflected recommendations to close a combined 2002-03 and 2003-04 budget gap of over $11.5 billion. These recommendations included savings from spending restraint of $6.3 billion, tobacco securitization proceeds of $3.8 billion, and revenue/fee increases of $1.4 billion. Assuming these budget recommendations were enacted in their entirety, the Executive Budget projected potential outyear budget gaps of $2.8 billion in 2004-05 and $4.1 billion in 2005-06.

The Legislature completed action on the budget for the 2003-04 fiscal year on May 15, overriding the Governor's vetoes of $3.2 billion in tax increases and spending additions. DOB (DOB) analysis of the Enacted Budget, which is detailed in this report and in a preliminary report released on May 1, 2003*, indicates that changes since the Executive Budget will increase General Fund spending by $2.3 billion above the levels recommended by the Governor. As compared to the Executive Budget, revenues are projected to increase by $1.4 billion, reflecting enacted tax and revenue increases offset by lower revenue results for 2002-03 and the April income tax settlement. This leaves the General Fund Financial Plan with a potential imbalance of roughly $900 million in 2003-04, and increases the outyear gaps by $3.7 billion in 2004-05 and $4.2 billion in 2005-06, before potential benefits provided by recently enacted Federal aid changes and savings from a Fiscal Management Plan being developed. Also excluded are revenues from certain measures enacted by the Legislature that DOB considers to be highly speculative at this time. The combination of Federal aid and management actions will keep the 2003-04 budget in balance and are discussed in more detail later in this report.

* Note: Reported in the May 2, 2003 Supplement to the 2002-03 AIS.

Summary of General Fund Revenue Changes

Legislative changes are projected to increase revenues by $1.9 billion in 2003-04, $1.4 billion in 2004-05, and $605 million in 2005-06. The outyear values of the revenue proposals decrease primarily because of "sunset" provisions enacted for the tax increases. In addition to these changes, revenues are projected to decrease from the Executive Budget forecast by $462 million in 2003-04 primarily due to the impact of 2002-03 actuals on the current year, and the April 2003 income tax settlement. The net 2003-04 revenue change since the Executive Budget is therefore $1.4 billion.

Not counted within these revenue totals are certain other revenue measures adopted by the Legislature that DOB considers to be speculative. Examples include receipts from video lottery terminals (VLTs) at racetracks, collection of cigarette and motor fuel taxes on Indian reservations, and use tax collections.

Net revenue changes since the Executive Budget include the following:

Net Revenue Changes from 30-Day Estimates Increases (Decreases) (millions of dollars)			
	2003-04	**2004-05**	**2005-06**
Personal Income Tax Surcharge	1,400	1,200	1,000
Increase Sales Tax by 1/4 Cent	450	572	100
Restrict Sales Tax on Clothing	86	(315)	(435)
Recapture Bonus Depreciation	58	100	90
Redirect State Sales Tax to NYC	(170)	(170)	(170)
Revenue Losses	(462)	(609)	(609)
All Other	39	20	20
Net Revenue Increases	**1,401**	**798**	**(4)**

These revenue changes and speculative revenue sources are described in more detail later in this report.

Summary of General Fund Spending Changes

General Fund spending is projected to increase from the Executive Budget by a net $2.3 billion in 2003-04, $4.5 billion in 2004-05 and $4.2 billion in 2005-06. This spending increase reflects net legislative restorations and adds to the Governor's 2003-04 Executive Budget, including the denial of the Governor's pension reform proposals included in the Executive Budget ($434 million in 2004-05 and $197 million in 2005-06, after deferring required 2003-04 payments with interest to 2005-06). It also reflects increased outyear costs resulting from the May 15, 2003 school aid database update ($184 million in 2004-05 and $60 million in 2005-06).

In addition, the net spending changes include costs DOB projects but which the Legislature believes may not occur. Examples include a $200 million lump sum appropriation for member items which DOB values at $200 million in costs and which the Legislature valued at $100 million; various Medicaid savings DOB believes are not fully attainable; and higher costs associated with shelter allowances for welfare recipients.

Net General Fund Spending Changes from 30-Day Estimates Increases (Decreases) (millions of dollars)			
	2003-04	**2004-05**	**2005-06**
Medicaid (including HCRA)	840	1,681	1,494
School Aid (including 5/15 Database update)	599	1,354	1,409
Member Items	200	0	0
Higher Education	193	323	303
Handicapped/All Other Education	132	110	111
Welfare	114	157	157
Public Health	40	100	136
General State Charges (including pension deferral)	34	555	338
State Operations	2	94	102
All Other	171	132	101
Net Spending Increases	**2,325**	**4,506**	**4,151**

These spending changes are described in more detail later in this report.

Spending Projections

As a result of the deferred tobacco securitization proceeds and payment delays, 2002-03 actual receipts and disbursements were understated by $1.9 billion and 2003-04 estimates will be overstated by a like amount. To provide a meaningful year-to-year comparison of receipts and disbursements, the 2002-03 actuals and 2003-04 Enacted Budget estimates have been adjusted for this transaction in most of the tabular data in this report. Specifically, Miscellaneous Receipts and various spending categories (mainly Grants to Local Governments) were increased by $1.9 billion in 2002-03 and decreased by a like amount in 2003-04. (See Financial Plan tables at the end of this report for the detailed adjustments.)

2002-03 General Fund Payment Deferrals (millions of dollars)	
School Aid	1,312
CUNY Senior Colleges	219
Medicaid Payment to Counties	82
Education	54
Welfare	47
All Other	186
Total Payment Deferrals	**1,900**

The following table summarizes current spending levels for the General Fund, State Funds and All Governmental Funds under the 2003-04 Enacted Budget, after adjusting for the 2002-03 payment deferrals.

2003-04 Spending Projections (millions of dollars)				
	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	$ Change from 2002-03	% Change from 2002-03
General Fund	39,513	40,837	1,324	3.4
State Funds	57,712	61,087	3,375	5.8
All Governmental Funds	90,956	94,474	3,518	3.9

Note: Adjusted actuals account for the impact of $1.9 billion in spending deferrals described earlier that would reduce 2002-03 actual spending and increase 2003-04 estimates from the amounts shown above.

Annual spending is projected to increase by $1.3 billion (3.4 percent) in the General Fund, by $3.4 billion (5.8 percent) in State Funds, and by $3.5 billion (3.9 percent) in All Governmental Funds. These changes are explained in more detail below, and do not reflect any increased Federal aid or possible spending reductions associated with the Fiscal Management Plan.

Fiscal Management Plan/Federal Assistance

The recently enacted Federal economic stimulus legislation provides $20 billion nationwide in fiscal relief to states, to be distributed as $10 billion in revenue sharing grants and $10 billion from a 15-month increase in the Federal share of Medicaid. DOB expects New York to receive $2.1 billion as a result of this legislation over the next two State fiscal years.

The State's revenue sharing grant is estimated to be $645 million. The impact of the 2.95 percent increase in the Federal share of Medicaid costs is estimated to yield $1.4 billion for the State and its local governments. The State's share of this total is roughly $900 million.

In order to manage cash flow, assure budget balance in the current fiscal year, and begin to address significant 2004-05 and 2005-06 budget gaps, the Governor has directed DOB to develop a Fiscal Management Plan to reduce State operations costs, curtail non-essential spending, and identify other cost containment actions to bring the General Fund into balance. This plan will be developed in cooperation with State agency managers and is expected to be detailed by the time the State's First Quarterly Financial Plan Update is released in July. Elements of the plan are expected to include:

- Continuing statewide austerity measures that limit discretionary spending, ban non-essential travel, and restrict or terminate lower-priority capital spending and other contractual liabilities.
- Mandating agency management plans to eliminate, consolidate, and streamline governmental services.
- Making significant further reductions in the State workforce.
- Maximizing Federal aid.
- Developing cost containment proposals that can be presented for legislative action later this year.

As noted in the messages accompanying the Governor's vetoes, certain appropriations and spending authorizations may be legally flawed. The State will review all such authorizations and continue to assess the degree to which any legal deficiencies may reduce overall spending levels.

DOB will also monitor and work to achieve additional revenues, as specified in the Senate Finance Committee Staff Report on the Budget, from certain measures enacted by the Legislature that DOB believes are speculative in nature and thus not reflected in the Financial Plan. These include Video Lottery Terminals (VLTs) at racetracks (legislative value of $150 million), collection of cigarette and motor fuel taxes on Indian Reservations (legislative value of $186 million), and collection of use tax

(legislative value of $25 million), as well as other measures that the Legislature believes will reduce the outyear gaps (casino revenue and streamlined sales tax are examples).

Explanation of the Financial Plan

The State's Enacted Budget Financial Plan forecasts receipts and disbursements for the fiscal year. The economic forecast of DOB and the State's tax and fee structure serve as the basis for projecting receipts. After consulting with public and private sector experts, DOB prepares a detailed economic forecast for both the nation and New York, showing Gross Domestic Product (GDP), employment levels, inflation, wages, consumer spending, and other relevant economic indicators. It then projects the yield of the State's revenue structure against the backdrop of these forecasts.

Projected disbursements are based on agency staffing levels, program caseloads, levels of service needs, formulas contained in State and Federal law, inflation and other factors. The factors that affect spending estimates vary by program. For example, welfare spending is based primarily on anticipated caseloads that are estimated by analyzing historical trends, projected economic conditions and changes in Federal law. In criminal justice, spending estimates are based on recent trends and data from the criminal justice system, as well as on estimates of the State's prison population. All projections account for the timing of payments, since not all the amounts appropriated in the Budget are disbursed in the same fiscal year.

The State's Fund Structure

The State accounts for all of its spending and receipts by the fund in which the activity takes place (such as the General Fund or the Capital Projects Fund), and the broad category or purpose of that activity (such as State Operations or Capital Projects). The Financial Plan tables sort all State projections and results by fund and category.

The General Fund receives the majority of State taxes. State Funds include the General Fund and funds specified for dedicated purposes, with the exception of Federal Funds. The All Governmental Funds Financial Plan, which includes State Funds and Federal Funds, is comprised of four major fund types, and includes:

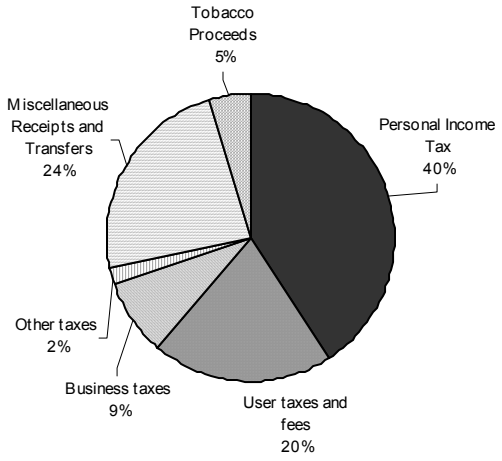
- The General Fund, which receives most of the State's tax revenue and accounts for spending on programs that are not supported directly by dedicated fees and revenues;
- Special Revenue Funds, which receive Federal grants, certain dedicated taxes, fees and other revenues that are used for a specified purpose;
- Capital Projects Funds, which account for costs incurred in the construction and reconstruction of roads, bridges, prisons, and other infrastructure projects; and
- Debt Service Funds, which pay principal, interest and related expenses on long-term bonds issued by the State and its public authorities.

Within each of these fund types, revenues and spending are classified by major categories of the Financial Plan (e.g., Taxes, Miscellaneous Receipts, Grants to Local Governments, State Operations). Activity in these Financial Plan categories is described in greater detail later in this Report. Summary charts display the annual change for each category of the Financial Plan, and a narrative explanation of major changes follows each chart. The tables at the end of the Report summarize projected General Fund, State Funds and All Governmental Funds receipts and disbursements for the 2003-04 fiscal year.

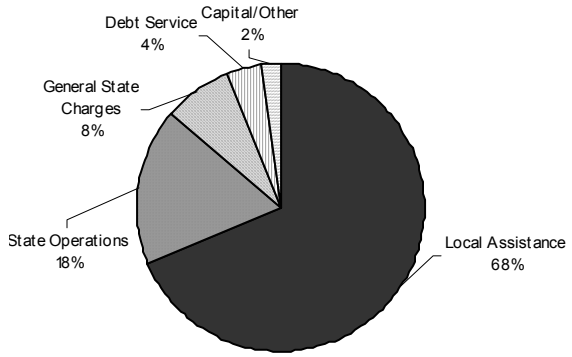
2003-04 General Fund Financial Plan

Where It Comes/Where It Goes

General Fund
2003-04 Adjusted Enacted



Receipts



Disbursements

The General Fund is the principal operating fund of the State and is used to account for all financial transactions except those required to be accounted for in another fund. It is the State's largest fund and receives almost all State taxes and other resources not dedicated to particular purposes. In the State's 2003-04 fiscal year, the General Fund is expected to account for approximately 41 percent of All Governmental Funds disbursements. General Fund moneys are also transferred to and from other funds, primarily to support certain capital projects and debt service payments in other fund types. The graphs above depict the components of projected receipts and disbursements in the General Fund (in percent).

Many complex political, social and economic forces influence the State's economy and finances, which may in turn affect the State Financial Plan and increase the likelihood that current projections will differ materially from the projections set forth in this Enacted Budget Report. These forces may affect the State unpredictably from fiscal year to fiscal year and are influenced by governments, institutions, and organizations that are not subject to the State's control. The 2003-04 Enacted Plan is also necessarily based upon forecasts of national and State economic activity. Economic forecasts have frequently failed to predict accurately the timing and magnitude of changes in the national and State economies.

National Economy

U.S. economic growth slowed to 1.6 percent during the first quarter of 2003, partly due to severe weather conditions and the uncertainty surrounding the war in Iraq. Now that the war is over, the nation's economic recovery is expected to gain momentum. The national economy grew at a slower pace than anticipated in the Executive Budget during early 2003. However, higher growth toward the end of the year is expected to bring real U.S. GDP growth up to 2.3 percent for 2003, only slightly below the Executive Budget projection of 2.4 percent. Buttressed by low inflation and high productivity growth, the national economy is expected to grow 3.4 percent during 2004.

Although a boost in Federal spending contributed positively to GDP growth, the impact of the war on the labor market was clearly negative, with 220,000 reservists having been called up for duty as of April 2003. The Budget Division now expects no net growth in employment for 2003, compared to the

0.6 percent growth projected in the Executive Budget. Income growth for 2003, especially in wages, is also expected to be modestly below the Executive Budget projection. This is mainly due to the downward revision made to the data for the third quarter of 2003 by the U.S. Bureau of Economic Analysis.

Higher output growth toward the end of this year is expected to be fueled by a rebound in private investment activity. If business sector financial conditions do not improve, hiring may be delayed, leading to an even weaker labor market than now anticipated. On the positive side of the ledger, given the current and lagged effects of expansionary monetary and fiscal policy, the economy could grow faster than expected. A lower dollar could lead to higher exports and, therefore, higher output growth.

Major Economic Indicators			
	2002	**2003**	**2004**
Gross Domestic Product (real)	2.4	2.3	3.4
Personal Income	2.8	3.8	5.2
Corporate Profits	(0.7)	12.7	15.2
Unemployment Rate	5.8	5.8	5.5
Consumer Price Index	1.6	2.5	2.3
Note: Numbers above are percent change/calendar year, except for unemployment rate. The New York State Division of the Budget estimates are based on National Income and Product Account data through April 2003, except for nonagricultural employment and the unemployment rate which are based on U.S. Department of Labor data through early May 2003.			

State Economy

The September 11th terrorist attack had a more severe impact on the New York economy than on that of any other state. Therefore, not surprisingly, the State's economy is only now emerging from the most recent recession.

DOB now estimates that State employment fell 1.8 percent in 2002, and wage income is estimated to have declined 3.8 percent. The unemployment rate for 2002 was 6.1 percent and is expected to remain virtually unchanged for 2003.

Employment growth was weaker than expected during the last quarter of 2002. The weaker job base, combined with the sluggishness of the national economic recovery, has led DOB to anticipate marginally lower employment growth for the 2003-04 State fiscal year than projected in the Executive Budget. Growth in wages and salaries is expected to be marginally lower as well.

In addition to the risks associated with the national economic forecast, there are specific risks to the State economy. Chief among them is a more prolonged downturn in the financial sector than is currently projected, producing sharper declines in both employment and compensation. Moreover, significant numbers of business relocations out of the State could imply slower job and income growth as well. In contrast, a stronger national economy than expected could result in stronger equity market growth and, in turn, a stronger demand for financial market services, fueling a rebound in income growth in that sector.

Major Economic Indicators			
	2002	**2003**	**2004**
Personal Income	0.0	3.0	4.1
Nonagricultural Employment	(1.8)	0.3	1.0
Unemployment Rate	6.1	6.0	5.5
Note: Numbers above are percent change/calendar year. Personal income and nonagricultural employment growth for 2002 and all forecasts for 2003 and 2004 are projected by DOB.			

General Fund Revenue Actions

Revenue actions included with the 2003-04 Enacted Budget include: a personal income tax increase ($1.4 billion); a limited liability company filing fee increase ($26 million); income tax withholding for certain partnerships ($15 million); reduced interest for late refunds ($5 million); increasing the State sales tax rate from 4 percent to 4.25 percent ($450 million); temporarily replacing the permanent sales tax exemption on items of clothing and shoes priced under $110 with a sales tax free week in August 2003 and another in January 2004 for the same items and thresholds ($449 million); including the New York City cigarette excise tax in the sales tax base ($7 million); changing the tax structure for insurance companies ($158 million); decoupling from the Federal bonus depreciation provisions ($58 million); decoupling from Federal expensing provisions for SUVs; and reducing the time period for collecting abandoned property related to the demutualization of insurance companies ($75 million). In total, the Budget includes over $2.4 billion in revenue actions including those contained in the Executive Budget.

As part of the Enacted Budget, the Legislature also enacted tobacco securitization legislation that creates a bankruptcy-remote corporation to securitize all or a portion of the State's future share of tobacco settlement payments. The corporation will issue debt backed by payments from the tobacco industry under the master settlement agreement (MSA) and a contingent-contractual obligation on behalf of the State to pay debt service if MSA payments prove insufficient. The structure is designed to reduce overall borrowing costs to a level comparable to a typical State bond sale.

The Financial Plan assumes net proceeds of $3.8 billion ($1.9 billion on an adjusted basis) from this transaction in 2003-04 and $400 million in 2004-05; these amounts are reflected as miscellaneous receipts in the Financial Plan. It is possible that, in order to reduce costs of issuance, take advantage of current low interest rates and improve its cash flow balances, the State may securitize amounts sufficient to receive the entire $4.2 billion in 2003-04, reserving the $400 million for 2004-05 budget balance.

General Fund Receipts

General Fund Receipts (millions of dollars)				
	2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
Total Tax Receipts	27,977	28,561	584	1,148
All Other Receipts	11,319	11,279	(40)	255
Total Receipts	**39,296**	**39,840**	**544**	**1,403**

Total General Fund receipts in support of the 2003-04 Financial Plan are projected to be $39.84 billion, an increase of $544 million from the $39.30 billion recorded in 2002-03. This total includes $28.56 billion in tax receipts, $3.67 billion in miscellaneous receipts, and $7.61 billion in transfers from other funds. The increase largely reflects the impact of revenue actions adopted with the Budget. There are additional legislative actions enacted with the 2003-04 Budget that may have a positive impact on revenues but are too speculative at this point to value with any confidence, including the addition of a use

tax line on the personal income tax return, non-resident sales of real property, six-day liquor sales, and VLTs.

General Fund receipts net of refund reserve account transactions are estimated at $39.69 billion for 2003-04. Adjusting for the impact of revenue actions, General Fund tax receipts have been reduced by $463 million from estimates released with the 30-day amendments to the Executive Budget. This revision reflects several factors including: the impact of lower-than-anticipated 2002-03 receipts on the 2003-04 revenue base; a modest net loss in personal income tax receipts due to a lower-than-expected net settlement of 2002 income tax liability in April and May; and continued weakness in corporate tax collections.

Personal Income Tax (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
16,791	16,285	(506)	833

General Fund personal income tax receipts are projected to decrease by $506 million from 2002-03. This is due to economic improvement in 2003-04 and enactment of a temporary tax increase, more than offset by a lower settlement for 2002 tax returns, a reduction in revenue reserves flowing through the refund reserve accounts, and a higher deposit into the Revenue Bond Tax Fund. Overall, net of law changes, personal income tax payments associated with the 2002 tax year are down modestly from what was anticipated in the Executive Budget.

The estimate for withholding tax collections increased by $1.03 billion from the Executive Budget estimate, reflecting the enacted temporary tax increase offset somewhat by lower wage growth than forecast with the Executive Budget. Estimated tax installment payments have been increased by $300 million, again reflecting the enacted temporary tax increase.

Additionally, reflecting April and May results on the settlement of 2002 tax liabilities, the estimate for payments with final returns has been increased by $100 million and the estimate for refunds has been increased by $175 million.

The estimate for delinquent collections of the personal income tax has been reduced by $50 million, reflecting the State tax amnesty program bringing greater-than-expected receipts forward into 2002-03.

General Fund personal income tax receipts, including refund reserve account transactions, are expected to be $833 million higher than the 30-day amendments to the Executive Budget adjusted for a higher net contribution from the refund reserve account. This increase is due to the temporary tax increase, offset somewhat by the lower-than-anticipated income tax settlement for 2002 tax liability, lower withholding resulting from a weaker-than-expected economy for 2003-04, lower expected assessment collections, and a higher STAR fund deposit due to the Legislature's rejection of the STAR spending limitation proposed in the Executive Budget.

User Taxes and Fees (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
7,063	8,007	944	499

Receipts for user taxes and fees for 2003-04 are projected to total $8.01 billion, an increase of $944 million from reported 2002-03 collections. Included in this category are: receipts from the State sales tax, cigarette and tobacco products taxes; alcoholic beverage taxes and fees; and motor vehicle license and registration fees.

The projected growth in sales tax cash receipts of 15.1 percent is largely attributable to the enactment of a temporary increase in the overall tax rate (to 4.25 percent) and a change in the clothing and footwear exemption. The Enacted Budget eliminated the exemption on items of clothing and footwear for one year, effective June 1, 2003, and replaced it with two temporary one-week exemptions with the same $110 thresholds -- one in August 2003 and another in January 2004. Growth in the sales tax base, after adjusting for tax law changes and other factors, is projected at 4.3 percent.

The decline in General Fund cigarette tax receipts is the result of a continuation of the long-term consumption decline in cigarettes.

User taxes and fees are expected to rise by $499 million from the 30-day amendments to the Executive Budget. This adjustment mainly reflects tax increases contained in the Enacted Budget.

Business Taxes (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
3,380	3,498	118	(184)

Receipts for business taxes for 2003-04 are projected to total $3.50 billion, an increase of $118 million from 2002-03 collections. Business taxes include the corporate franchise tax, corporation and utilities taxes, the insurance franchise tax, and the bank franchise tax. Business tax receipts for 2003-04 have been revised down by $184 million from the 30-day amendments to the Executive Budget to reflect lower 2002-03 actuals during closeout and anticipated enhanced refund activity. These negatives in 2002-03 have been offset by the effect of decoupling from the Federal bonus depreciation.

Corporate franchise tax receipts have been revised down by $141 million from the 30-day amendments to the Executive Budget. The difference is attributable to a closeout adjustment and enhanced refund activity. These reductions are offset by an increase in revenues of $58 million based on decoupling from Federal bonus depreciation provisions.

Corporation and utilities taxes, and insurance franchise tax receipts remain unchanged from the 30-day Executive Budget estimate.

Bank tax receipts are estimated to be $43 million lower than the 30-day Executive Budget estimate. This result is primarily attributable to continued weak earnings growth, and the decline in the 2002-03 base.

Other Taxes (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
743	771	28	0

Other tax receipts are now projected to total $771 million or $28 million above last year's amount. Sources in this category include the estate and gift tax, the real property gains tax and pari-mutuel taxes.

Previously enacted legislation to repeal both the real property gains tax and the gift tax and to reduce the estate and pari-mutuel taxes have significantly reduced the yield from this category of receipts.

Other taxes estimated in this category are unchanged from the 30-day estimate.

Miscellaneous Receipts (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
3,991	3,669	(322)	90

Miscellaneous receipts, adjusted for the tobacco securitization, are expected to reach $3.67 billion, a decrease of $322 million from 2002-03 and an increase of $90 million from the 30-day estimate. The annual decrease in receipts is the result of several non-recurring actions taken in the 2002-03 Enacted Budget, including transferring available balances from various State authorities. The increase in receipts from the 30-day estimates is attributed to a delay in the collection of a settlement recovery from various Wall Street firms originally expected in 2002-03, as well as the net impact of several legislative actions, which on balance increase receipts by an estimated $50 million.

Transfers From Other Funds (millions of dollars)				
	2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
PIT in Excess of Revenue Bond Debt Service	4,215	5,125	910	260
Sales Tax in Excess of LGAC Debt Service	1,919	1,853	(66)	(146)
Real Estate Taxes in Excess of CW/CA Debt Service	263	202	(61)	0
All Other Transfers	931	430	(501)	51
Total Transfers From	**7,328**	**7,610**	**282**	**165**

Transfers from other funds are expected to total $7.61 billion, or $282 million more than total receipts from this category during 2002-03 and $165 million higher than the 30-day estimates. The $910 million year-to-year increase in transfers of personal income tax (PIT) in excess of revenue bond debt service requirements is primarily attributable to higher dedicated PIT receipts ($1.1 billion), including legislative tax increases, offset by increased debt service requirements ($222 million). The $260 million net increase from the 30-day estimate reflects the legislative tax increases, offset by increased debt service costs.

The annual decrease of $66 million in transfers from the sales tax in excess of LGAC debt service reflects increased debt service requirements ($67 million) and an annual payment to New York City intended to cover debt service costs related to restructuring NYC MAC debt for City fiscal relief ($170 million), offset by increased sales tax receipts ($171 million). The 2003-04 estimate is $146 million lower than the 30-day estimate primarily due to the legislation requiring a payment of State sales tax to New York City.

Provisions enacted with the 2003-04 Budget relating to the Local Government Assistance Corporation (LGAC) and the Municipal Assistance Corporation of the City of New York (MAC) appear to intend that the State assume responsibility for debt service payments on the remaining $2.5 billion in outstanding MAC bonds. Thirty annual payments of $170 million from sales tax receipts dedicated to LGAC are authorized to be pledged to a New York City-created not-for-profit corporation allowing the maturity of the debt to be extended through 2034, well beyond the original 2008 maturity of the outstanding MAC debt. The structure of this bonding may be flawed and counsel are continuing to evaluate the constitutional and legal issues raised by the legislation, the implications on the State's Debt Reform Act of 2000, and the impact on LGAC and other bondholders.

The annual decline of $61 million in transfers from the real estate transfer tax is due to a projected decrease in tax receipts ($43 million) and an increase in Clean Water/Clean Air debt service requirements ($18 million). The 2003-04 enacted estimate is unchanged from the 30-day estimate.

The $501 million expected annual decrease in all other transfers is primarily due to the loss of one-time 2002-03 transfers from the Environmental Protection Fund ($269 million) and Federal reimbursement of World Trade Center related costs ($231 million). All other transfers increased by $51 million from the 30-day estimates due to an increase in expected receipts for the Waste Tire Management Recycling Act ($20 million) and one-time transfers from various non-General funds ($31 million).

General Fund Disbursements

General Fund Disbursements (millions of dollars)				
	2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
Welfare	496	1,127	631	114
General State Charges	2,732	3,199	467	34
Member Items	105	455	350	200
Medicaid (including HCRA)	5,951	6,269	318	840
Public Health	525	566	41	40
School Aid (including 5/15 database update)	12,278	12,312	34	599
Handicapped/All Other Education	1,341	1,323	(18)	132
Higher Education	1,528	1,488	(40)	193
State Operations	7,715	7,168	(547)	2
All Other	6,842	6,930	88	171
Total General Fund Disbursements	**39,513**	**40,837**	**1,324**	**2,325**

Total General Fund disbursements, including transfers to support capital projects, debt service and other purposes, are estimated at $40.84 billion for 2003-04, an increase of $1.32 billion or 3.4 percent from 2002-03. The annual growth in spending is primarily attributable to the use of non-recurring offsets in the previous fiscal year for welfare assistance programs ($631 million), higher costs for General State

Charges mostly due to pensions and health insurance ($467 million), additional spending for member items ($350 million), and growth in Medicaid ($318 million), offset by lower State Operations spending ($547 million). The annual change in spending is explained by financial plan category in more detail below.

Total projected spending in the 2003-04 Enacted Budget is $2.33 billion higher than the level recommended in the Governor's Executive Budget. Spending changes primarily reflect net legislative restorations and adds in Medicaid ($840 million), school aid ($599 million), funding for member items ($200 million), higher education programs ($193 million), handicapped/all other education programs ($132 million), and welfare programs ($114 million).

In addition, the net spending changes include certain costs resulting from the Legislature's action or inaction on several spending items. Examples include a $200 million lump sum appropriation for member items which the Legislature valued at $100 million; various Medicaid savings DOB believes are not fully attainable including additional Federal reimbursement for prescription drug costs and home care costs; and inaction on cost containment provisions which DOB believes results in higher welfare costs.

Grants to Local Governments (millions of dollars)

2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
26,713	28,009	1,296	2,229

Grants to Local Governments (also known as local assistance) include financial aid to local governments and non-profit organizations, as well as entitlement payments to individuals. The largest shares of spending in local assistance are for aid to public schools (44 percent) and for the State's share of Medicaid payments to medical providers (22 percent). Spending for mental hygiene programs (6 percent), higher education programs (5 percent), welfare assistance (4 percent), and children and families services (4 percent) represent the next largest areas of local aid.

Spending in local assistance is estimated at $28.01 billion in 2003-04, an increase of $1.30 billion (4.9 percent) over the 2002-03 fiscal year. This net spending growth is primarily attributable to welfare assistance programs ($631 million), Medicaid ($318 million), additional spending in the Community Projects Fund ($350 million), higher spending for the Higher Education Service Corporation ($123 million) and various other local assistance programs. These increases are partially offset by an annual decline in spending for the City University of New York ($176 million) and a scheduled decline in payments for the Yonkers settlement agreement ($110 million).

General Fund spending for school aid on a State fiscal year basis is projected at $12.31 billion in 2003-04, an increase of $34 million over 2002-03. This net increase reflects the "tail" cost of the 2002-03 school year increase offset in part by the reduced spending in the 2003-04 enacted school year aid package. On a school year basis, school aid is projected at $14.43 billion for 2003-04, a decrease of $185 million from the prior school year. This decrease is primarily due to a reduction in operating aid ($285 million), which is partially offset by increases in transportation aid, excess cost aid and BOCES.

Medicaid spending is estimated at $6.27 billion in 2003-04, an increase of $318 million (5.3 percent) from the prior year. The net increase is primarily attributable to expected underlying spending growth of approximately 8 percent ($478 million), the sunset of the Tobacco Transfer Fund used to reimburse medical care providers for services rendered to Medicaid patients ($91 million), the Federally mandated phase out of the nursing home intergovernmental transfers ($90 million), and the reduction of the nursing home gross receipts assessment used to offset Medicaid costs ($78 million). The growth in Medicaid

spending is partially offset by increased Federal aid from an increase in disproportionate share payments to public hospitals ($324 million), additional financing through the Health Care Reform Act ($117 million), and various cost containment proposals, as well as the phase out of Disaster Relief Medicaid related to the September 11th attack on the World Trade Center. In addition, the Enacted Budget "rolls" the last Medicaid cycle payable on March 31, 2004 to the first day of the 2004-05 fiscal year ($170 million), decreasing 2003-04 and increasing 2004-05 costs. The Medicaid estimate does not include possible savings related to the temporary increase in the Federal share of Medicaid costs.

Spending on welfare is projected at $1.13 billion, an increase of $631 million (127.2 percent) from 2002-03. This increase is due primarily to the use of Federal TANF reserve funds to offset welfare spending in 2002-03 ($465 million) and the increased cost of the welfare caseload ($166 million). The projected welfare caseload of 622,067 recipients represents an increase from 2002-03 of approximately 10,248 recipients.

Higher Education Services Corporation (HESC) spending is projected at $442 million, an increase of $123 million (38.6 percent) from 2002-03. This increase reflects underlying program growth ($163 million) and a reduction in available Federal TANF funds ($64 million), offset by a deferral of Tuition Assistance Program costs into the 2004-05 fiscal year ($104 million).

City University of New York (CUNY) spending is projected at $681 million, a decrease of $176 million (20.5 percent) from 2002-03. The decrease is primarily due to the impact of a tuition increase at the senior colleges used to offset General Fund spending ($91 million) and a reduction in costs due to a one-time retroactive collective bargaining payment made in 2002-03 ($70 million).

Spending for all other local assistance programs will total $7.18 billion in 2003-04, a net increase of $366 million (5.4 percent) from the 2002-03 fiscal year. This increase is largely attributable to additional spending for member items ($350 million), increased spending for children and family services ($90 million), public health programs ($41 million), mental hygiene programs ($27 million), and various other local assistance programs. These increases are offset by spending declines across other agencies and programs including an annual decrease in the funding for the Yonkers settlement agreement ($110 million).

The 2003-04 enacted estimate for local assistance spending increased by $2.23 billion from the 30-day estimate primarily as a result of net legislative adds and restorations of Executive Budget proposals. The largest adds and restorations occurred in Medicaid ($840 million), school aid ($599 million), additional funding for the Community Projects Fund ($200 million), higher education programs ($193 million), handicapped/all other education programs ($132 million), and welfare programs ($114 million). These net legislative adds reflect resources identified by the Legislature to delay the last Medicaid cycle in the 2003-04 fiscal year to the following fiscal year ($170 million) and defer Tuition Assistance Program payments to colleges out of 2003-04 into 2004-05 ($104 million).

State Operations (millions of dollars)			
2002-03 Adjusted Actuals	**2003-04 Adjusted Enacted**	**Annual $ Change**	**Change from 30-Day Estimate**
7,715	7,168	(547)	2

State Operations accounts for the cost of operating the Executive, Legislative, and Judicial branches of government. Spending in this category is projected at $7.17 billion, a decrease of $547 million or 7.1 percent from 2002-03. The annual decline in State Operations spending is comprised of lower spending in both personal service ($493 million) and non-personal service ($54 million).

The State Operations estimates reflect $1.03 billion in savings initiatives. Included in these savings are $363 million from continuation of the strict Statewide hiring freeze, aggressive use of a retirement incentive for State employees, and various actions to restrain non-personal service spending in all agencies. A total of $662 million in savings is projected to be available in 2003-04 from a variety of revenue maximization efforts to finance State Operations spending. Among these savings are additional SUNY revenues from an anticipated tuition increase and other revenue measures used to support General Fund costs ($325 million), additional Federal revenues to offset spending on mental hygiene programs ($174 million), and various shifts of General Fund costs to other funds ($133 million) -- most notably funding $93 million in Department of Motor Vehicles transportation-related spending in the Dedicated Highway Fund.

The savings initiatives and revenue maximization efforts are partially offset by base spending growth of $478 million, including normal salary step increases and required non-personal service cost increases and the loss of one-time offsets used in 2002-03. Virtually all Executive agencies are held flat or reduced from 2002-03 levels.

The 2003-04 State Operations estimate is $2 million higher than the estimate prepared at the time of the 30-day Amendments to the Executive Budget in February 2003. This additional spending represents minor legislative changes to the Executive Budget estimates.

The State's All Funds workforce is projected to be 186,000 at the end of 2003-04, a decrease of approximately 10,000 from November 2001 when the Governor announced a series of cost savings actions following the World Trade Center attacks. This reduction resulted from attrition and the use of early retirement incentives. Additional declines are possible as a result of the Fiscal Management Plan to be implemented during the fiscal year.

General State Charges
(millions of dollars)

2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
2,732	3,199	467	34

General State Charges (GSCs) account for the costs of providing fringe benefits to State employees and retirees of the Executive, Legislative and Judicial branches, as well as certain fixed costs of the State. Fringe benefit payments, many of which are mandated by statute or collective bargaining agreements, include employer contributions for pensions, social security, health insurance, workers' compensation and unemployment insurance. Fixed costs include State payments-in-lieu-of-taxes to local governments for certain State-owned lands, and the costs of litigation against the State and its public officers.

Total spending for GSCs is estimated at $3.20 billion, an increase of $467 million or 17.0 percent from the prior year. The projected annual growth is primarily attributable to higher pension and health insurance costs.

Pension investment losses resulting in significantly higher contributions to the New York State and Local Retirement System for the 2003-04 fiscal year. The employer pension contribution rate is the Executive Budget was projected to increase to 4 percent of payroll in 2003-04, increasing pension costs by $250 million (171 percent). Pension reform legislation approved with the Enacted Budget requires a minimum pension contribution equal to 4.5 percent of payroll annually. This change along with higher than expected retirement incentive costs would increase the 2003-04 fiscal year contribution by an additional $94 million to $344 million. However, the Legislature did not provide sufficient appropriation

authority to allow the entire pension bill to be paid to the retirement system in 2003-04. As a result, it is anticipated that the State will pay this unbudgeted amount in 2005-06 at 8 percent annual interest, for a total cost of approximately $110 million.

Health insurance premiums are expected to increase by approximately $178 million (11 percent) in 2003-04 to cover the rising costs of employee and retiree health care. The enacted budget reflects $43 million in health benefit changes, which is expected to reduce the underlying growth in employee health insurance costs from $221 million (13.7 percent). These changes, some of which are subject to negotiations with State employee unions, would: place restrictions on pharmacy benefits, require a higher co-payments for prescription drugs, modernize the hospital benefit plan, and increase employee co-payments, deductibles and coinsurance levels for doctor visits.

The $34 million increase from the 30-day estimate is largely the result of the Legislature's denial of a proposal to change to the current 9 percent statutory interest rate on Court of Claims judgments to market-based rates, and partial restoration of Executive Budget proposals to change employee health insurance benefits.

Transfers to Other Funds (millions of dollars)

	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
Transfers in Support of Debt Service	1,496	1,583	87	0
Transfers in Support of Capital Projects	170	251	81	45
Transfers in Support of State University	26	145	119	0
All Other Transfers	661	482	(179)	15
Total Transfers to Other Funds	**2,353**	**2,461**	**108**	**60**

Transfers to other funds are expected to total $2.46 billion, or $108 million higher than total receipts from this category during 2002-03 and $60 million higher than the 30-day estimates. The annual net increase in debt service transfers of $87 million reflects planned growth in underlying debt service costs, offset by debt reduction efforts. As compared to the 30-day estimate, transfers in support of debt service remain unchanged.

Transfers for capital projects provide General Fund support for projects that are not financed by bond proceeds, dedicated taxes, Federal grants or other revenues. The $81 million projected increase in 2003-04 reflects year-to-year increases in pay-as-you-go spending for legislative adds for transportation and the environment ($49 million) and changes in the timing of the receipt of bond proceeds to reimburse capital spending. Compared to the 30-day estimate for 2003-04, the $45 million increase in capital projects transfers reflects the legislative adds for transportation and the environment.

The State's cost of transfers to the State University are estimated to increase by $119 million over 2002-03 due to the timing of State subsidy payments to the SUNY hospitals ($107 million) and the use of Dormitory Authority funds in 2002-03 to help subsidize the SUNY hospitals ($12 million). This transfer remained unchanged from the 30-day estimate.

All other transfers are estimated to total $482 million in 2003-04, a decline of $179 million from 2002-03. This decline is primarily due to decreases in the Community Service Provider Assistance Program ($100 million), the State's share of Medicaid payments to SUNY hospitals ($48 million), and payments to the State Lottery Fund ($17 million). All other transfers increased $15 million from the 30-day estimates.

Non-Recurring Actions

A total of $5.1 billion in gross nonrecurring actions, with a net impact of $3.2 billion on the Financial Plan, are incorporated in the 2003-04 Enacted Budget. These include resources from the securitization of tobacco settlement payments ($3.8 billion), the use of Federal TANF moneys to offset General Fund welfare, HESC, and school aid program spending ($458 million), spending delays for a Medicaid cycle and TAP payments ($274 million), the one-time shift of various pay-as-you-go capital projects to bonding ($122 million), debt management actions to reduce debt service costs ($161 million), recoveries of school aid and welfare overpayments ($88 million), abandoned property collections ($75 million), and various routine fund sweeps ($138 million).

The 2003-04 spending projections include $1.9 billion of one-time payment delays from 2002-03 pending receipt of tobacco securitization proceeds. These one-time payment deferrals are "matched-up" with $1.9 billion of the $3.8 billion tobacco proceeds, for a net one-time impact of $3.2 billion ($5.1 billion of total actions offset by $1.9 billion linked to one-time costs).

General Fund Closing Balance

The Enacted Budget Financial Plan projects a closing General Fund balance of $730 million at the end of the 2003-04 fiscal year, unchanged from the 30-day projection. The closing balance represents monies on deposit in the Tax Stabilization Reserve Fund ($710 million) and the Contingency Reserve Fund ($20 million). The balance assumes achievement of $912 million of savings from the Fiscal Management Plan including additional Federal aid described earlier.

Governmental Funds Financial Plans

State Funds

State Funds represent the portion of the State's budget supported exclusively by State revenues: taxes, fees, fines, and other revenues imposed and collected by the State. Federal grants are not included as part of State Funds.

State Funds Receipts (millions of dollars)

	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
Taxes	40,676	42,672	1,996	1,541
Miscellaneous Receipts	15,903	17,483	1,580	297
Total State Funds Receipts	**56,579**	**60,155**	**3,576**	**1,838**

Total State Funds receipts are projected to total $60.16 billion in 2003-04, an increase of $3.58 billion or 6.3 percent from 2002-03. State Funds tax receipts are projected to total $42.67 billion, an increase of $2.0 billion from 2002-03 primarily reflecting a new personal income tax surcharge ($1.4 billion) and a one-quarter percent increase in sales tax ($450 million), offset by revenue losses associated with the closeout of 2002-03 and the April PIT settlement ($462 million). These changes are discussed in more detail in the General Fund section above.

Miscellaneous receipts in the State Funds are projected to total $17.48 billion, an increase of $1.58 billion over 2002-03. The growth in miscellaneous receipts primarily reflects the timing of the receipt of bond proceeds to reimburse capital spending from the Dedicated Highway and Bridge Trust Fund ($961 million), economic development spending that is not counted by the State Comptroller as spending even

though the bond proceeds are counted as State-supported debt ($325 million), and growth in SUNY revenues primarily attributable to an anticipated tuition increase ($280 million). These increases are offset by a decline in General Fund miscellaneous receipts primarily due to the loss of non-recurring actions ($322 million).

The increase in State Funds receipts of $1.84 billion over the 30-day estimates is comprised of a projected tax increase of $1.54 billion and miscellaneous receipts increase of $297 million. The projected tax growth is consistent with the enacted tax increases described above. The growth in miscellaneous receipts is primarily attributable to the timing of the receipt of bond proceeds to reimburse capital spending ($482 million), offset by a decline in State Funds receipts in support of Medicaid due to the legislative restoration of the proposed home care and hospital assessments ($281 million).

Total State Funds disbursements are projected at $61.09 billion in 2003-04, an increase of $3.38 billion or 5.8 percent from 2002-03. Of this amount, $1.32 billion is due to a net increase in General Fund spending as described in detail above, and $2.05 billion is due to growth in other State funds.

State Funds Disbursements (millions of dollars)

	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
Welfare	496	1,127	631	114
General State Charges	3,088	3,608	520	43
Medicaid	8,413	8,852	439	559
Community Projects Fund	105	455	350	200
Debt Service	3,038	3,387	349	27
Public Health	2,023	2,218	195	88
SUNY	4,043	4,225	182	58
STAR	2,664	2,800	136	93
School Aid	14,121	14,225	104	608
Transportation	3,521	3,600	79	42
Handicapped/All Other Education	1,522	1,443	(79)	152
Mental Hygiene	2,645	2,572	(73)	42
Public Protection	2,902	2,899	(3)	18
All Other	9,131	9,676	545	172
Total State Funds Disbursements	**57,712**	**61,087**	**3,375**	**2,216**

State Funds Medicaid spending growth of $439 million (5.2 percent) reflects increased General Fund spending of $318 million (discussed in the General Fund section above) and an increase of $121 million in Special Revenue Funds. Additional HCRA financing for the Family Health Plus program, workforce recruitment and retention initiatives, and additional funding for Medicaid pharmacy costs represent $389 million of the net growth in the Special Revenue Funds. This increase is partially offset by lower spending attributable to the use of available pool balances in the Indigent Care Fund ($125 million) in 2002-03, the sunset of the Tobacco Transfer Fund used to reimburse medical care providers for services rendered to Medicaid patients ($91 million), and the legislative reduction of the nursing home gross receipts assessment from 6 percent to 5 percent ($45 million).

Spending from Debt Service Funds is estimated to increase by $349 million or 11.5 percent from 2002-03. The net increase in debt service spending reflects planned growth in costs, and additional bonding enacted by the Legislature for the CHIPs capital program and equipment for E-911 cellular emergency systems. Net debt service costs increased modestly ($27 million) from the 30-day estimates.

Public Health spending supported by State Funds is projected to increase $195 million (9.6 percent) from the prior year, of which the General Fund supports $41 million. The increase in other State-supported spending is primarily attributable to additional spending for the Elderly Pharmaceutical Insurance Coverage Program (EPIC) providing senior citizens with prescription drug insurance ($105 million) and the Child Health Plus program providing health insurance to children up to age 19 ($68 million).

Projected annual spending growth of $182 million for SUNY is primarily attributable to enrollment growth at the State-operated campuses, hospital program expansion, and anticipated increases in disbursements for capital programs. The annual growth in the STAR program of $136 million is mainly due to inflation and increased taxpayer participation.

Annual State Funds spending growth due mostly to General Fund changes include: Welfare ($631 million), primarily reflecting the use of non-recurring Federal TANF reserve funds to offset 2002-03 welfare spending; General State Charges ($520 million), primarily due to higher pension and health insurance costs; and increased spending from the Community Projects Funds ($350 million).

Major areas experiencing modest annual increases or decreases on a State Funds basis include: school aid (up $104 million), transportation (up $79 million), handicapped/all other education (down $79 million), mental hygiene (down $73 million) and public protection (down $3 million).

State Funds disbursements increased $2.22 billion over the 30-day estimates primarily due to net legislative changes including school aid ($608 million), Medicaid ($559 million), the Community Projects Fund ($200 million), handicapped/all other education ($152 million), and welfare ($114 million).

All Governmental Funds

All Governmental Funds includes activity in the four governmental funds types: the General Fund, Special Revenue Funds, Capital Projects Funds, and Debt Service funds. All Governmental Funds spending combines State funds (discussed earlier) with Federal grants across these fund types. It excludes Fiduciary, Internal Services, and Enterprise Funds.

All Governmental Funds Receipts (millions of dollars)

	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
Taxes	40,676	42,672	1,996	1,541
Miscellaneous Receipts	16,056	17,705	1,649	301
Federal Grants	33,242	33,444	202	1,426
Total All Governmental Funds Receipts	**89,974**	**93,821**	**3,847**	**3,268**

All Governmental Funds receipts are projected to be $93.82 billion in 2003-04, an increase of $3.85 billion or 4.3 percent from 2002-03. Tax receipts are projected to increase by $2.0 billion to total $42.67 billion primarily reflecting the impact of the enacted tax increases previously discussed.

Miscellaneous receipts are projected to increase by $1.65 billion to total $17.71 billion over 2002-03. The growth in All Governmental Funds miscellaneous receipts primarily reflects the timing of the receipt of bond proceeds to reimburse capital spending, economic development spending, and SUNY tuition increases, offset by a decline in General Fund miscellaneous receipts as discussed above.

Federal Grants are projected to total $33.44 billion, an increase of $202 million from 2002-03. Federal grants represent reimbursement from the Federal government for programs financed by the State in the first instance. Federal receipts are generally assumed to be received in the State fiscal year in which spending is incurred; therefore, the revisions to Federal receipts correspond to the adjustments to the federally-reimbursed spending revisions described below.

The All Governmental Funds receipts increase of $3.27 billion over the 30-day estimates is comprised of enacted tax increases described above and Federal grants of $1.43 billion primarily due to increases in Medicaid spending.

All Governmental Funds spending is estimated at $94.47 billion in 2003-04, an annual increase of $3.52 billion or 3.9 percent. The spending growth is comprised of the State Funds increases of $3.38 billion and growth in Federal Funds of $143 million. The growth in Federal spending is primarily due to increases for Medicaid ($1.02 billion), offset by declines in welfare ($426 million), World Trade Center costs ($302 million) and education ($180 million).

All Governmental Funds Disbursements (millions of dollars)

	2002-03 Adjusted Actuals	2003-04 Adjusted Enacted	Annual $ Change	Change from 30-Day Estimate
Medicaid	25,315	26,778	1,463	2,003
Public Health	3,230	3,778	548	137
General State Charges	3,272	3,774	502	43
Community Projects Fund	105	455	350	200
Debt Service	3,038	3,387	349	27
Welfare	2,803	3,008	205	124
Mental Hygiene	4,983	5,174	191	45
SUNY	4,208	4,368	160	58
STAR	2,664	2,800	136	93
School Aid	14,121	14,225	104	608
Handicapped/All Other Education	3,922	3,663	(259)	187
Transportation	4,907	4,834	(73)	13
Public Protection	3,096	3,027	(69)	18
All Other	15,292	15,203	(89)	109
Total All Funds Disbursements	**90,956**	**94,474**	**3,518**	**3,665**

All Governmental Funds Medicaid spending growth of $1.46 billion reflects previously discussed State Funds spending growth of $439 million, and an increase of $1.02 billion (6.1 percent) in Medicaid spending supported by Federal Funds, which are estimated to total $26.78 billion in 2003-04. The net increase is primarily attributable to expected underlying spending growth of approximately 8 percent ($1.10 billion) and increased aid governed from an increase in disproportionate share payments to public hospitals ($394 million). This increase is partially offset by the mandated phase out of the nursing home intergovernmental transfers ($119 million), the phase out of Disaster Relief Medicaid related to the

September 11th attack on the World Trade Center ($83 million), nonrecurring additional indigent care payments ($72 million), and various other cost containment proposals. The Medicaid estimate does not include possible savings related to the temporary increase in the Federal share of Medicaid costs.

Public health spending supported by All Governmental Funds is expected to increase by $548 million from 2002-03 of which $195 million is attributable to increased State Funds support and the remaining $353 million consisting of additional Federal aid. The growth in Federal aid is largely attributable to increased spending for the Child Health Plus program ($324 million).

Spending from All Governmental Funds in support of welfare initiatives increased $205 million from 2002-03 actuals and reflects the State Funds increase described above ($631 million) offset by decreased welfare spending from federal funds ($426 million). The decreased spending is primarily due to the loss of one-time credits that were used to support 2002-03 spending.

All Governmental Funds spending growth largely attributable to State Funds spending includes growth for General State Charges ($502 million), Community Projects Fund ($350 million), debt service ($349 million), SUNY ($160 million), STAR ($136 million), and school aid ($104 million).

Major areas experiencing modest annual increases or decreases on an All Governmental Funds basis include: mental hygiene (up $191 million), handicapped/all other education (down $259 million), transportation (down $73 million), and public protection (down $69 million).

All Governmental Funds disbursements increased $3.67 billion over the 30-day estimates due to State Funds spending increases of $2.22 billion described above and growth in Federal Medicaid spending ($1.45 billion) attributable to legislative restorations of various cost containment and revenue maximizations, as well as revised estimates for underlying Federal Medicaid spending.

First Quarter Cash Flow

Unlike previous years, the 2003-04 General Fund first quarter cash flow estimates assume continued implementation of emergency cash management actions implemented after delays in enacting tobacco securitization legislation led to potential cash imbalances. The General Fund cash flow position is expected to be extremely tight during the first quarter of the 2003-04 fiscal year and thus requires continued management actions to maintain positive balances until $2.1 billion of tobacco proceeds are received in late June. DOB continues to monitor cash balances on a daily basis and has administratively managed the flow of funds and disbursements while continuing essential governmental operations through a statewide austerity plan. Under the current cash management plan, daily cash balances are expected to fluctuate significantly.

The General Fund balances assume continued deferrals of discretionary payments through June, including school aid payments scheduled in May and early June until the State receives the tobacco securitization proceeds. Thereafter, cash balances are expected to be healthy until March of the fiscal year.

The General Fund is projected to end May with a balance of $2.15 billion. This balance, along with June receipts, will be used to make the school aid payment deferred from March on June 2 ($1.2 billion) as well as weekly Medicaid, payroll, and other critical payments. As a result, cash balances are expected to decline to very low levels by mid-June. The State expects to make the remaining May and June school aid payments ($2.5 billion) in late June upon the receipt of tobacco securitization proceeds. Absent these proceeds, General Fund resources would be insufficient to pay school aid and end the month with a positive cash balance.

The 2003-04 Enacted Budget amends State Finance Law to permit the State Comptroller to make balances in other funds and accounts temporarily available to the General Fund for intra-month cash flow needs as long as such balances can be repaid by the end of the month. This provision is set to expire on March 31, 2004.

GAAP-Basis Financial Plans

The February Financial Plan included General Fund Financial Plans prepared in accordance with Generally Accepted Accounting Principles (GAAP) for State fiscal years 2002-03 through 2005-06. The accounting principles that DOB applied in preparing the GAAP projections are consistent with those applied by the State Comptroller for the 2001-02 GAAP-basis Financial Statements. Accordingly, the projections do not reflect the impact of any pending proposals of the Governmental Accounting Standards Board, including GASB 34. The changes mandated by GASB 34 are expected to significantly change the presentation of GAAP-basis financial results for state and local governments in 2002-03.

The General Fund GAAP Financial Plan issued as part of the February Financial Plan projected that the State would end the 2002-03 fiscal year with an operating imbalance of $2.74 billion. The operating result reflected the use of reserves in response to the World Trade Center disaster. As a result of the operating deficit, the accumulated surplus was projected to decline from $492 million at the end of 2001-02 to a $2.24 billion accumulated deficit at the end of 2002-03.

Certain legislative actions, including deferring a Medicaid Cycle ($170 million), and delaying TAP payments ($104 million) are expected to negatively impact the GAAP Financial Plan.

Additionally, the deferral of $1.9 billion in spending from 2002-03 until 2003-04 is expected to increase the 2002-03 accumulated GAAP-basis deficit, since the deferred payments are expected to be accrued to the 2002-03 fiscal year. However, the tobacco settlement revenues originally anticipated in 2002-03 but now expected in 2003-04 are likely to be accrued to the 2003-04 fiscal year resulting in no net change to the accumulated GAAP deficit by the end of 2003-04.

DOB expects to update the GAAP Financial Plan estimates for 2003-04 in the First Quarterly Financial Plan Update to be issued in July 2003.

Outyear General Fund Financial Plan Projections

General Fund budget gaps for the 2004-05 and 2005-06 fiscal years have increased significantly from the 30-day projections. It is currently estimated that spending and revenue actions in the Enacted Budget in concert with events since presentation of the Executive Budget will increase gaps to over $6 billion in 2004-05 and $8 billion in 2005-06, before reflecting savings from the Fiscal Management Plan or extra Federal aid. The Fiscal Management Plan savings will be implemented in 2003-04, and these actions coupled with new Federal assistance are expected to produce recurring savings in the outyears, reducing the gaps by approximately $900 million in each year.

Future budget gaps are subject to substantial revision as additional information becomes available about the national and State economies, financial sector activity, entitlement spending and social service caseloads, and State reimbursement obligations that are driven by local government activity. Key factors include: end-of-year business tax collections; calendar year economic results; year-end financial sector bonus income data; the school aid database update in November; and quarterly Medicaid cycle trend analysis.

These factors have historically been subject to a high degree of fluctuation across the forecast period, and could produce results above or below the current projections.

The outyear gap estimates do not assume any collective bargaining salary increases. If the projected budget gap for 2004-05 is closed fully with recurring actions, the 2005-06 budget gap would be reduced to under $2 billion.

Revenues are projected to increase from the Executive Budget as a result of legislative changes by $1.4 billion in 2004-05 and $605 million in 2005-06. The revenue proposals decrease primarily because of "sunset" provisions enacted for the tax increases. New revenue actions include a personal income tax surcharge ($1.2 billion in 2004-05 and $1.0 billion in 2005-06), one-quarter percent increase in sales tax ($572 million in 2004-05 and $100 million in 2005-06), and a decoupling from Federal bonus depreciation provisions ($100 million in 2004-05 and $90 million in 2005-06). These revenue actions are offset by the loss of receipts due to the sales tax free week proposed in the Executive Budget ($315 million in 2004-05 and $435 million in 2005-06), and the intended transfer of State sales tax receipts to New York City ($170 million annually).

In addition, revenues are expected to decrease by $609 million in 2004-05 and 2005-06 primarily reflecting the impact of 2002-03 actuals and the April 2003 PIT settlement.

As compared to the Executive Budget, spending is projected to increase by $4.5 billion in 2004-05 and $4.2 billion in 2005-06. This spending increase reflects revisions based on actual results and net legislative adds to the Governor's Executive Budget, including Medicaid programs ($1.7 billion in 2004-05 and $1.5 billion in 2005-06), school aid, including revised estimates resulting from the May 15 database update ($1.4 billion in 2004-05 and 2005-06), higher education ($323 million in 2004-05 and $303 million in 2005-06), and higher general state charges primarily driven by restorations of health insurance savings initiatives and the planned payment of the full required pension bill in 2004-05 and 2005-06 ($555 million in 2004-05 and $338 million in 2005-06).

2004-05 spending grows $2.2 billion above the $2.3 billion increase in 2003-04 from the Executive Budget (for a total 2004-05 increase of $4.5 billion). This incremental growth is driven by the annualization of Medicaid restorations ($403 million), HCRA ($268 million), and the deferral of a 2003-04 Medicaid cycle into 2004-05 ($170 million), the "tail" of school aid adds and restorations including the loss of proposed BOCES and Building Aid reforms ($571 million), the May 15 school aid database revisions ($184 million), and increased fringe benefits costs including the denial of the Governor's proposed pension reforms and the restoration of proposed health insurance cost containment ($521 million).

Fiscal Management Plan savings include continuing the statewide austerity measures implemented during 2003-04, mandating agencies to eliminate, consolidate, and streamline governmental services, reducing the State workforce further, maximizing Federal aid, and planning legislative actions that may include statutory modifications to programs.

A more detailed discussion of these revenue and spending changes, as well as the Fiscal Management Plan, is described in the Overview and General Fund sections above.

CASH FINANCIAL PLAN
GENERAL FUND
2002-2003 and 2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	2002-2003 Adjusted Actual	2003-2004 Adjusted Enacted	Annual Change
Opening fund balance	1,032	815	(217)
Receipts:			
Taxes:			
Personal income tax	16,791	16,285	(506)
User taxes and fees	7,063	8,007	944
Business taxes	3,380	3,498	118
Other taxes	743	771	28
Miscellaneous receipts	3,991	3,669	(322)
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	4,215	5,125	910
Sales tax in excess of LGAC debt service	1,919	1,853	(66)
Real estate taxes in excess of CW/CA debt service	263	202	(61)
All other	931	430	(501)
Total receipts	39,296	39,840	544
Disbursements:			
Grants to local governments	26,713	28,009	1,296
State operations	7,715	7,168	(547)
General State charges	2,732	3,199	467
Transfers to other funds:			
Debt service	1,496	1,583	87
Capital projects	170	251	81
State University	26	145	119
Other purposes	661	482	(179)
Total disbursements	39,513	40,837	1,324
Fiscal Management Plan/Federal Aid	0	912	912
Change in fund balance	(217)	(85)	132
Closing fund balance	815	730	(85)
Tax Stabilization Reserve Fund	710	710	0
Contingency Reserve Fund	20	20	0
Community Projects Fund	85	0	(85)

CASH FINANCIAL PLAN
GENERAL FUND
2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	30-Day	Change	Adjusted Enacted
Opening fund balance	805	10	815
Receipts:			
Taxes:			
Personal income tax	15,452	833	16,285
User taxes and fees	7,508	499	8,007
Business taxes	3,682	(184)	3,498
Other taxes	771	0	771
Miscellaneous receipts	3,579	90	3,669
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	4,865	260	5,125
Sales tax in excess of LGAC debt service	1,999	(146)	1,853
Real estate taxes in excess of CW/CA debt service	202	0	202
All other	379	51	430
Total receipts	38,437	1,403	39,840
Disbursements:			
Grants to local governments	25,780	2,229	28,009
State operations	7,166	2	7,168
General State charges	3,165	34	3,199
Transfers to other funds:			
Debt service	1,583	0	1,583
Capital projects	206	45	251
State university	145	0	145
Other purposes	467	15	482
Total disbursements	38,512	2,325	40,837
Fiscal Management Plan/Federal Aid	0	912	912
Change in fund balance	(75)	(10)	(85)
Closing fund balance	730	0	730
Tax Stabilization Reserve Fund	710	0	710
Contingency Reserve Fund	20	0	20

Note: The 30-Day opening fund balance was reduced by $198 million and the personal income tax receipts were increased by $198 million to reflect the tax refund reserve transaction.

CASH FINANCIAL PLAN
GENERAL FUND
2002-2003 and 2003-2004
(millions of dollars)

	2002-2003 Actual	2003-2004 Enacted	Change
Opening fund balance	1,032	815	(217)
Receipts:			
Taxes:			
Personal income tax	16,791	16,285	(506)
User taxes and fees	7,063	8,007	944
Business taxes	3,380	3,498	118
Other taxes	743	771	28
Miscellaneous receipts	2,091	5,569	3,478
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	4,215	5,125	910
Sales tax in excess of LGAC debt service	1,919	1,853	(66)
Real estate taxes in excess of CW/CA debt service	263	202	(61)
All other	931	430	(501)
Total receipts	37,396	41,740	4,344
Disbursements:			
Grants to local governments	24,887	29,835	4,948
State operations	7,678	7,205	(473)
General State charges	2,699	3,232	533
Transfers to other funds:			
Debt service	1,496	1,583	87
Capital projects	166	255	89
State University	26	145	119
Other purposes	661	482	(179)
Total disbursements	37,613	42,737	5,124
Fiscal Management Plan/Federal Aid	0	912	912
Change in fund balance	(217)	(85)	132
Closing fund balance	815	730	(85)
Tax Stabilization reserve Fund	710	710	0
Contingency Reserve Fund	20	20	0
Community Projects Fund	85	0	(85)

Note: Actuals reflect the amounts published in the Comptroller's Cash Basis Report released on April 15, 2003.

CASH FINANCIAL PLAN
GENERAL FUND
2002-2003
(millions of dollars)

	Actual	Adjustments	Adjusted Actual
Opening fund balance	1,032	0	1,032
Receipts:			
Taxes:			
Personal income tax	16,791	0	16,791
User taxes and fees	7,063	0	7,063
Business taxes	3,380	0	3,380
Other taxes	743	0	743
Miscellaneous receipts	2,091	1,900	3,991
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	4,215	0	4,215
Sales tax in excess of LGAC debt service	1,919	0	1,919
Real estate taxes in excess of CW/CA debt service	263	0	263
All other	931	0	931
Total receipts	37,396	1,900	39,296
Disbursements:			
Grants to local governments	24,887	1,826	26,713
State operations	7,678	37	7,715
General State charges	2,699	33	2,732
Transfers to other funds:		.	
Debt service	1,496	0	1,496
Capital projects	166	4	170
State University	26	0	26
Other purposes	661	0	661
Total disbursements	37,613	1,900	39,513
Change in fund balance	(217)	0	(217)
Closing fund balance	815	0	815
Tax Stabilization Reserve Fund	710	0	710
Contingency Reserve Fund	20	0	20
Community Projects Fund	85	0	85

Note: Actuals reflect the amounts published in the Comptroller's Cash Basis Report released on April 15, 2003.

CASH FINANCIAL PLAN
GENERAL FUND
2003-2004
(millions of dollars)

	Enacted	Adjustments	Adjusted Enacted
Opening fund balance	815	0	815
Receipts:			
Taxes:			
Personal income tax	16,285	0	16,285
User taxes and fees	8,007	0	8,007
Business taxes	3,498	0	3,498
Other taxes	771	0	771
Miscellaneous receipts	5,569	(1,900)	3,669
Transfers from other funds:			
PIT in excess of Revenue Bond debt service	5,125	0	5,125
Sales tax in excess of LGAC debt service	1,853	0	1,853
Real estate taxes in excess of CW/CA debt service	202	0	202
All other	430	0	430
Total receipts	41,740	(1,900)	39,840
Disbursements:			
Grants to local governments	29,835	(1,826)	28,009
State operations	7,205	(37)	7,168
General State charges	3,232	(33)	3,199
Transfers to other funds:			
Debt service	1,583	0	1,583
Capital projects	255	(4)	251
State University	145	0	145
Other purposes	482	0	482
Total disbursements	42,737	(1,900)	40,837
Fiscal Management Plan/Federal Aid	912	0	912
Change in fund balance	(85)	0	(85)
Closing fund balance	730	0	730
Tax Stabilization Reserve Fund	710	0	710
Contingency Reserve Fund	20	0	20

Note: The 30-Day opening fund balance was reduced by $198 million and the personal income tax receipts were increased by $198 million to reflect the PIT refund reserve transaction.

CURRENT STATE RECEIPTS
GENERAL FUND
2002-2003 and 2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	2002-2003 Adjusted Actual	2003-2004 Adjusted Enacted	Annual Change
Personal income tax	16,791	16,285	(506)
User taxes and fees	7,063	8,007	944
Sales and use tax	6,328	7,285	957
Cigarette and tobacco taxes	446	425	(21)
Motor vehicle fees	67	75	8
Alcoholic beverages taxes	180	180	0
Alcoholic beverage control license fees	42	42	0
Business taxes	3,380	3,498	118
Corporation franchise tax	1,407	1,450	43
Corporation and utilities tax	860	805	(55)
Insurance taxes	704	818	114
Bank tax	409	425	16
Other taxes	743	771	28
Estate tax	701	737	36
Gift tax	7	0	(7)
Real property gains tax	5	2	(3)
Pari-mutuel taxes	29	31	2
Other taxes	1	1	0
Total taxes	27,977	28,561	584
Miscellaneous receipts	3,991	3,669	(322)
Total	31,968	32,230	262

Note: Adjusted miscellaneous receipts include $1.9 billion in tobacco securitization proceeds in 2002-03 that will be received in 2003-04.

CURRENT STATE RECEIPTS
ALL GOVERNMENTAL FUNDS
2002-2003 and 2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	2002-2003 Adjusted Actual	2003-2004 Adjusted Enacted	Change
Personal income tax	23,698	24,460	762
User taxes and fees	10,804	11,984	1,180
Sales and use taxes	8,796	9,956	1,160
Cigarette and tobacco taxes	446	425	(21)
Motor fuel tax	544	537	(7)
Motor vehicle fees	612	651	39
Highway use tax	147	149	2
Alcoholic beverage taxes	180	180	0
Alcoholic beverage control license fees	42	42	0
Auto rental tax	37	44	7
Business taxes	4,983	5,052	69
Corporation franchise tax	1,612	1,655	43
Corporation and utilities taxes	1,091	993	(98)
Insurance taxes	776	903	127
Bank tax	481	500	19
Petroleum business taxes	1,023	1,001	(22)
Other taxes	1,191	1,176	(15)
Estate tax	701	737	36
Gift tax	7	0	(7)
Real property gains tax	5	2	(3)
Real estate transfer tax	448	404	(44)
Pari-mutuel taxes	29	32	3
Other taxes	1	1	0
Total taxes	40,676	42,672	1,996
Miscellaneous receipts	16,056	17,705	1,649
Federal grants	33,242	33,444	202
Total	89,974	93,821	3,847

Note: Adjusted miscellaneous receipts include $1.9 billion in tobacco securitization proceeds in 2002-03 that will be received in 2003-04.

GENERAL FUND
TAX REFUND RESERVE ACCOUNT
2002-2003 AND 2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	2002-2003 Adjusted Actual	2003-2004 Adjusted Enacted	Annual Change
Withholdings	19,959	22,135	2,176
Estimated Payments	4,855	4,780	(75)
Final Payments	1,334	1,241	(93)
Delinquencies	796	670	(126)
Gross Collections	26,944	28,826	1,882
State/City Offset	(288)	(300)	(12)
Refund Reserve	1,050	159	(891)
Refunds	(4,008) (1)	(4,225) (2)	(217)
Reported Tax Collections	23,698	24,460	762
STAR	(2,664)	(2,800)	(136)
RBTF	(4,243)	(5,375)	(1,132)
General Fund	16,791	16,285	(506)

Net personal income tax collections are affected by transactions in the tax refund reserve account. The tax refund reserve account is used to hold moneys designated to pay tax refunds. The Comptroller deposits receipts into this account at the discretion of the Commissioner of Taxation and Finance. The deposit of moneys into the account during a fiscal year has the effect of reducing receipts for the fiscal year, and the withdrawal of moneys from the account has the effect of increasing receipts in the fiscal year of withdrawal. The tax refund reserve account also includes amounts made available as a result of the LGAC financing program. Beginning in 1998-99, a portion of personal income tax collections is deposited directly in the School Tax Reduction (STAR) Fund and used to make payments to reimburse local governments for their revenue decreases due to the STAR program.

Note 1: Reflects the payment of the balance of refunds on 2001 liability and payment of $960 million of calendar year 2002 refunds in the last quarter of the State's 2002-03 fiscal year and a balance in the Tax Refund Reserve Account of $627 million.

Note 2: Reflects the payment of the balance of refunds on 2002 liability and the projected payment of $960 million of calendar year 2003 refunds in the last quarter of the State's 2003-04 fiscal year and a projected balance in the Tax Refund Reserve Account of $468 million.

CASH FINANCIAL PLAN
STATE FUNDS
2003-2004
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	894	(560)	158	1,307
Receipts:					
Taxes	28,561	4,401	1,765	7,945	42,672
Miscellaneous receipts	5,569	9,880	3,232	702	19,383
Federal grants	0	0	0	0	0
Total receipts	34,130	14,281	4,997	8,647	62,055
Disbursements:					
Grants to local governments	29,835	10,191	1,095	0	41,121
State operations	7,205	4,561	0	8	11,774
General State charges	3,232	410	0	0	3,642
Debt service	0	0	0	3,387	3,387
Capital projects	0	2	3,061	0	3,063
Total disbursements	40,272	15,164	4,156	3,395	62,987
Other financing sources (uses):					
Transfers from other funds	7,610	801	401	4,844	13,656
Transfers to other funds	(2,465)	(231)	(1,068)	(10,093)	(13,857)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,145	570	(419)	(5,249)	47
Fiscal Management Plan/Federal Aid	912	0	0	0	912
Change in fund balance	(85)	(313)	422	3	27
Closing fund balance	730	581	(138)	161	1,334

CASH FINANCIAL PLAN
STATE FUNDS
2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	894	(560)	158	1,307
Receipts:					
Taxes	28,561	4,401	1,765	7,945	42,672
Miscellaneous receipts	3,669	9,880	3,232	702	17,483
Federal grants	0	0	0	0	0
Total receipts	32,230	14,281	4,997	8,647	60,155
Disbursements:					
Grants to local governments	28,009	10,191	1,095	0	39,295
State operations	7,168	4,561	0	8	11,737
General State charges	3,199	410	0	0	3,609
Debt service	0	0	0	3,387	3,387
Capital projects	0	2	3,057	0	3,059
Total disbursements	38,376	15,164	4,152	3,395	61,087
Other financing sources (uses):					
Transfers from other funds	7,610	801	397	4,844	13,652
Transfers to other funds	(2,461)	(231)	(1,068)	(10,093)	(13,853)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,149	570	(423)	(5,249)	47
Fiscal Management Plan/Federal Aid	912	0	0	0	912
Change in fund balance	(85)	(313)	422	3	27
Closing fund balance	730	581	(138)	161	1,334

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
2003-2004
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	986	(791)	158	1,168
Receipts:					
Taxes	28,561	4,401	1,765	7,945	42,672
Miscellaneous receipts	5,569	10,102	3,232	702	19,605
Federal grants	0	31,806	1,638	0	33,444
Total receipts	34,130	46,309	6,635	8,647	95,721
Disbursements:					
Grants to local governments	29,835	38,677	1,312	0	69,824
State operations	7,205	7,790	0	8	15,003
General State charges	3,232	576	0	0	3,808
Debt service	0	0	0	3,387	3,387
Capital projects	0	2	4,350	0	4,352
Total disbursements	40,272	47,045	5,662	3,395	96,374
Other financing sources (uses):					
Transfers from other funds	7,610	3,221	401	4,844	16,076
Transfers to other funds	(2,465)	(2,594)	(1,200)	(10,093)	(16,352)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,145	627	(551)	(5,249)	(28)
Fiscal Management Plan/Federal Aid	912	0	0	0	912
Change in fund balance	(85)	(109)	422	3	231
Closing fund balance	730	877	(369)	161	1,399

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	(MEMO) Total
Opening fund balance	815	986	(791)	158	1,168
Receipts:					
Taxes	28,561	4,401	1,765	7,945	42,672
Miscellaneous receipts	3,669	10,102	3,232	702	17,705
Federal grants	0	31,806	1,638	0	33,444
Total receipts	32,230	46,309	6,635	8,647	93,821
Disbursements:					
Grants to local governments	28,009	38,677	1,312	0	67,998
State operations	7,168	7,790	0	8	14,966
General State charges	3,199	576	0	0	3,775
Debt service	0	0	0	3,387	3,387
Capital projects	0	2	4,346	0	4,348
Total disbursements	38,376	47,045	5,658	3,395	94,474
Other financing sources (uses):					
Transfers from other funds	7,610	3,221	397	4,844	16,072
Transfers to other funds	(2,461)	(2,594)	(1,200)	(10,093)	(16,348)
Bond and note proceeds	0	0	248	0	248
Net other financing sources (uses)	5,149	627	(555)	(5,249)	(28)
Fiscal Management Plan/Federal Aid	912	0	0	0	912
Change in fund balance	(85)	(109)	422	3	231
Closing fund balance	730	877	(369)	161	1,399

CASH FINANCIAL PLAN
SPECIAL REVENUE FUNDS
2003-2004
(millions of dollars)

	State	Federal	Total
Opening fund balance	894	92	986
Receipts:			
Taxes	4,401	0	4,401
Miscellaneous receipts	9,880	222	10,102
Federal grants	0	31,806	31,806
Total receipts	14,281	32,028	46,309
Disbursements:			
Grants to local governments	10,191	28,486	38,677
State operations	4,561	3,229	7,790
General State charges	410	166	576
Debt service	0	0	0
Capital projects	2	0	2
Total disbursements	15,164	31,881	47,045
Other financing sources (uses):			
Transfers from other funds	801	2,420	3,221
Transfers to other funds	(231)	(2,363)	(2,594)
Bond and note proceeds	0	0	0
Net other financing sources (uses)	570	57	627
Change in fund balance	(313)	204	(109)
Closing fund balance	581	296	877

CASH FINANCIAL PLAN
CAPITAL PROJECTS FUNDS
2003-2004
ADJUSTED FOR 2002-2003 DELAYS
(millions of dollars)

	State	Federal	Total
Opening fund balance	(560)	(231)	(791)
Receipts:			
Taxes	1,765	0	1,765
Miscellaneous receipts	3,232	0	3,232
Federal grants	0	1,638	1,638
Total receipts	4,997	1,638	6,635
Disbursements:			
Grants to local governments	1,095	217	1,312
State operations	0	0	0
General State charges	0	0	0
Debt service	0	0	0
Capital projects	3,057	1,289	4,346
Total disbursements	4,152	1,506	5,658
Other financing sources (uses):			
Transfers from other funds	397	0	397
Transfers to other funds	(1,068)	(132)	(1,200)
Bond and note proceeds	248	0	248
Net other financing sources (uses)	(423)	(132)	(555)
Change in fund balance	422	0	422
Closing fund balance	(138)	(231)	(369)

CASH FLOW
GENERAL FUND
2003-2004
(millions of dollars)

	April	May	June
Opening fund balance	815	2,786	2,145
Receipts:			
Taxes:			
Personal income tax	2,811	304	1,582
Sales tax	450	462	737
User taxes and fees	103	56	59
Business taxes	56	(128)	722
Other taxes	49	67	73
Miscellaneous receipts	70	103	2,239
Transfers from other funds	898	330	782
Total receipts	4,437	1,194	6,194
Disbursements:			
Grants to local governments	1,462	694	5,284
State operations	743	814	611
General State charges	32	241	236
Transfers to other funds	229	86	350
Total disbursements	2,466	1,835	6,481
Change in fund balance	1,971	(641)	(287)
Closing fund balance	2,786	2,145	1,858

Special Considerations

Many complex political, social, and economic forces influence the State's economy and finances, which may in turn affect the State's Financial Plan. These forces may affect the State unpredictably from fiscal year to fiscal year and are influenced by governments, institutions, and events that are not subject to the State's control. The Financial Plan is also necessarily based upon forecasts of national and State economic activity. Economic forecasts have frequently failed to predict accurately the timing and magnitude of changes in the national and State economies. DOB believes that its current estimates related to the performance of the State and national economies are reasonable. However, there can be no assurance that actual results will not differ materially and adversely from the current forecast. For a discussion of the DOB economic forecast, see the sections entitled "Economic and Demographics," "Current Fiscal Year – National Economy" and "Current Fiscal Year – State Economy" in this AIS.

Based on current projections, the 2003-04 Financial Plan depends in part on the implementation of a fiscal management plan to maintain budget balance in the current fiscal year. The plan currently under development by DOB is expected to contain a range of actions that can be implemented administratively, as well as proposals that may require legislative approval. The fiscal management plan will also integrate savings from the Federal aid package enacted by Congress on May 23, 2003. DOB estimates the Federal package will provide the State and localities a total of $2.1 billion in fiscal relief over the next two State fiscal years, consisting of a temporary 2.95 percent increase in the Federal matching rate for State Medicaid expenditures (valued at $1.5 billion) and unrestricted aid payments (valued at $645 million). The Federal aid is expected to enhance the State's flexibility in preparing the fiscal management plan and maintaining a balanced budget in the 2003-04 fiscal year. DOB expects to incorporate the fiscal management plan into the Financial Plan projections by the release of the First Quarterly Update to the Financial Plan.

The Executive is reviewing legal questions surrounding certain actions taken by the Legislature in enacting the 2003-04 budget. The State Constitution provides that the Legislature may not alter an appropriation bill submitted by the Governor except to strike out or reduce items, or to add appropriations that are stated separately and distinctly from the original appropriations. A number of court cases have interpreted and clarified the Legislature's powers to act on the appropriations contained in the Executive Budget (see the section entitled "Litigation" for a discussion of two ongoing cases). In light of the provisions of the State Constitution and existing case law, the Executive believes that the Legislature, in enacting changes to the Governor's Executive Budget for 2003-04, may have acted in a manner that violates State constitutional and statutory requirements.

Labor contracts between the State and most State employee unions expired on March 31, 2003 and collective bargaining negotiations are underway on a new round of contracts. The Financial Plan contains no reserves to finance potential new costs related to any new labor agreements. DOB projects that every one percent increase in salaries for all State employees would result in a General Fund Financial Plan cost of approximately $80 million.

DOB expects the State's cash flow position to experience pressure in the first quarter of the 2004-05 fiscal year. A number of administrative options are available to DOB to manage General Fund cash flow needs during any fiscal year. The State is prohibited from issuing seasonal notes in the public credit markets to finance cash flow needs, unless the State satisfies certain restrictive conditions imposed under the Local Government Assistance Corporation ("LGAC") statute and related bond covenants. For a discussion of the LGAC restrictions, see the section entitled "Debt and Other Financing Activities – Local Government Assistance Corporation" in this AIS.

An ongoing risk to the Financial Plan arises from the potential impact of certain litigation and Federal disallowances now pending against the State, which could produce adverse effects on the State's projections of receipts and disbursements. For example, the Federal government has issued a draft disallowance for certain claims, and deferred the payment of other claims, submitted by school districts related to school supportive health services. It is unclear at this time what impact, if any, such disallowances may have on the State Financial Plan in the current year or in the future. The Financial Plan assumes no significant Federal disallowances or other Federal actions that could adversely affect State finances. For more information on certain litigation pending against the State, see the section entitled "Litigation" in this AIS.

In the past, the State has taken management actions to address potential financial plan shortfalls, and DOB believes it could take similar actions should adverse variances occur in its projections for the current fiscal year. To help guard against such risks, the State is maintaining a total of $730 million in General Fund reserves, after implementation of the fiscal management plan.

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APPENDIX C

MASTER SETTLEMENT AGREEMENT

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MASTER SETTLEMENT AGREEMENT

(AS AMENDED BY THE ADDENDUM OF CLARIFICATIONS)

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MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures, as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and

"ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or, solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States.

(g) "Allocated Payment" means a particular Settling State's Allocable Share of the sum of all of the payments to be made by the Original Participating Manufacturers in the year in question pursuant to subsections IX(c)(1) and IX(c)(2), as such payments have been adjusted, reduced and allocated pursuant to clause "First" through the first sentence of clause "Fifth" of subsection IX(j), but before application of the other offsets and adjustments described in clauses "Sixth" through "Thirteenth" of subsection IX(j).

(h) "Bankruptcy" means, with respect to any entity, the commencement of a case or other proceeding (whether voluntary or involuntary) seeking any of (1) liquidation, reorganization, rehabilitation, receivership, conservatorship, or other relief with respect to such entity or its debts under any bankruptcy, insolvency or similar law now or hereafter in effect; (2) the appointment of a trustee, receiver, liquidator, custodian or similar official of such entity or any substantial part of its business or property; (3) the consent of such entity to any of the relief described in (1) above or to the appointment of any official described in (2) above in any such case or other proceeding involuntarily commenced against such entity; or (4) the entry of an order for relief as to such entity under the federal bankruptcy laws as now or hereafter in effect. Provided, however, that an involuntary case or proceeding otherwise within the foregoing definition shall not be a "Bankruptcy" if it is or was dismissed within 60 days of its commencement.

(i) "Brand Name" means a brand name (alone or in conjunction with any other word), trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any domestic brand of Tobacco Products. Provided, however, that the term "Brand Name" shall not include the corporate name of any Tobacco Product Manufacturer that does not after the MSA Execution Date sell a brand of Tobacco Products in the States that includes such corporate name.

(j) "Brand Name Sponsorship" means an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way. Sponsorship of a single national or multi-state series or tour (for example, NASCAR (including any number of NASCAR races)), or of one or more events within a single national or multi-state series or tour, or of an entrant, participant, or team taking part in events sanctioned by a single approving organization (e.g., NASCAR or CART), constitutes one Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in an event that is part of a series or tour that is sponsored by such Participating Manufacturer or that is part of a series or tour in which any one or more events are sponsored by such Participating Manufacturer does not constitute a separate Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in any event (or series of events) not sponsored by such Participating Manufacturer constitutes a Brand Name Sponsorship. The term "Brand Name Sponsorship" shall not include an event in an Adult-Only Facility.

(k) "Business Day" means a day which is not a Saturday or Sunday or legal holiday on which banks are authorized or required to close in New York, New York.

(l) "Cartoon" means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:

(1) the use of comically exaggerated features;

(2) the attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or

(3) the attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

The term "Cartoon" includes "Joe Camel," but does not include any drawing or other depiction that on July 1, 1998, was in use in any State in any Participating Manufacturer's corporate logo or in any Participating Manufacturer's Tobacco Product packaging.

(m) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "Cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). Except as provided in subsections II(z) and II(mm), 0.0325 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(n) "Claims" means any and all manner of civil (i.e., non-criminal): claims, demands, actions, suits, causes of action, damages (whenever incurred), liabilities of any nature including civil penalties and punitive damages, as well as costs, expenses and attorneys' fees (except as to the Original Participating Manufacturers' obligations under section XVII), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable, or statutory.

(o) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

(q) "Escrow" has the meaning given in the Escrow Agreement.

(r) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(s) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(t) "Federal Tobacco Legislation Offset" means the offset described in section X.

(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual

Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including, but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in (1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

(2) is the first purchaser anywhere for resale in the States of Cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the States; or

(3) becomes a successor of an entity described in subsection (1) or (2) above.

The term "Tobacco Product Manufacturer" shall not include an Affiliate of a Tobacco Product Manufacturer unless such Affiliate itself falls within any of subsections (1) - (3) above.

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location. Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than

14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa)"Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

III. PERMANENT RELIEF

(a) Prohibition on Youth Targeting. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) Ban on Use of Cartoons. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) Limitation of Tobacco Brand Name Sponsorships.

(1) Prohibited Sponsorships. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) Limited Sponsorships.

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) Related Sponsorship Restrictions. With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

(D) nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) Corporate Name Sponsorships. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) Naming Rights Prohibition. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) Prohibition on Sponsoring Teams and Leagues. No Participating Manufacturer may enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) Elimination of Outdoor Advertising and Transit Advertisements. Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) Removal. Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) Prohibition on New Outdoor Advertising and Transit Advertisements. No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) Alternative Advertising. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) Ban on Agreements Inhibiting Anti-Tobacco Advertising. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the

use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) Designation of Contact Person. Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) Adult-Only Facilities. To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) Prohibition on Payments Related to Tobacco Products and Media. No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) Ban on Tobacco Brand Name Merchandise. Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) Ban on Youth Access to Free Samples. After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) Ban on Gifts to Underage Persons Based on Proofs of Purchase. Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) Limitation on Third-Party Use of Brand Names. After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to

whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) Ban on Non-Tobacco Brand Names. No Participating Manufacturer may, pursuant to any agreement requiring the payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) Minimum Pack Size of Twenty Cigarettes. No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) Corporate Culture Commitments Related to Youth Access and Consumption. Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;

designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and

encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) Limitations on Lobbying. Following State-Specific Finality in a Settling State:

(1) No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

(2) Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling

State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

(A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);

(B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

(3) No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) Restriction on Advocacy Concerning Settlement Proceeds. After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc. ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

(p) Regulation and Oversight of New Tobacco-Related Trade Associations.

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) Prohibition on Agreements to Suppress Research. No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) Prohibition on Material Misrepresentations. No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

IV. PUBLIC ACCESS TO DOCUMENTS

(a) After the MSA Execution Date, the Original Participating Manufacturers and the Tobacco-Related Organizations will support an application for the dissolution of any protective orders entered in each Settling State's lawsuit identified in

Exhibit D with respect only to those documents, indices and privilege logs that have been produced as of the MSA Execution Date to such Settling State and (1) as to which defendants have made no claim, or have withdrawn any claim, of attorney-client privilege, attorney work-product protection, common interest/joint defense privilege (collectively, "privilege"), trade-secret protection, or confidential or proprietary business information; and (2) that are not inappropriate for public disclosure because of personal privacy interests or contractual rights of third parties that may not be abrogated by the Original Participating Manufacturers or the Tobacco-Related Organizations.

(b) Notwithstanding State-Specific Finality, if any order, ruling or recommendation was issued prior to September 17, 1998 rejecting a claim of privilege or trade-secret protection with respect to any document or documents in a lawsuit identified in Exhibit D, the Settling State in which such order, ruling or recommendation was made may, no later than 45 days after the occurrence of State-Specific Finality in such Settling State, seek public disclosure of such document or documents by application to the court that issued such order, ruling or recommendation and the court shall retain jurisdiction for such purposes. The Original Participating Manufacturers and Tobacco-Related Organizations do not consent to, and may object to, appeal from or otherwise oppose any such application for disclosure. The Original Participating Manufacturers and Tobacco-Related Organizations will not assert that the settlement of such lawsuit has divested the court of jurisdiction or that such Settling State lacks standing to seek public disclosure on any applicable ground.

(c) The Original Participating Manufacturers will maintain at their expense their Internet document websites accessible through "TobaccoResolution.com" or a similar website until June 30, 2010. The Original Participating Manufacturers will maintain the documents that currently appear on their respective websites and will add additional documents to their websites as provided in this section IV.

(d) Within 180 days after the MSA Execution Date, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of the following documents, except as provided in subsections IV(e) and IV(f) below:

(1) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in any action identified in Exhibit D or any action identified in section 2 of Exhibit H that was filed by an Attorney General. Among these documents, each Original Participating Manufacturer and Tobacco-Related Organization will give the highest priority to (A) the documents that were listed by the State of Washington as trial exhibits in the State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King); and (B) the documents as to which such Original Participating Manufacturer or Tobacco-Related Organization withdrew any claim of privilege as a result of the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County);

(2) all documents that can be identified as having been produced by, and copies of transcripts of depositions given by, such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date in the litigation matters specified in section 1 of Exhibit H; and

(3) all documents produced by such Original Participating Manufacturer or Tobacco-Related Organization as of the MSA Execution Date and listed by the plaintiffs as trial exhibits in the litigation matters specified in section 2 of Exhibit H.

(e) Unless copies of such documents are already on its website, each Original Participating Manufacturer and Tobacco-Related Organization will place on its website copies of documents produced in any production of documents that takes place on or after the date 30 days before the MSA Execution Date in any federal or state court civil action concerning smoking and health. Copies of any documents required to be placed on a website pursuant to this subsection will be placed on such website within the later of 45 days after the MSA Execution Date or within 45 days after the production of such documents in any federal or state court action concerning smoking and health. This obligation will continue until June 30, 2010. In placing such newly produced documents on its website, each Original Participating Manufacturer or Tobacco-Related Organization will identify, as part of its index to be created pursuant to subsection IV(h), the action in which it produced such documents and the date on which such documents were added to its website.

(f) Nothing in this section IV shall require any Original Participating Manufacturer or Tobacco-Related Organization to place on its website or otherwise disclose documents that: (1) it continues to claim to be privileged, a trade secret, confidential or proprietary business information, or that contain other information not appropriate for public disclosure because of personal privacy interests or contractual rights of third parties; or (2) continue to be subject to any protective order, sealing order or other order or ruling that prevents or limits a litigant from disclosing such documents.

(g) Oversized or multimedia records will not be required to be placed on the Website, but each Original Participating Manufacturers and Tobacco-Related Organizations will make any such records available to the public by placing copies of them in the document depository established in The State of Minnesota, et al. v. Philip Morris Incorporated, et al., C1-94-8565 (County of Ramsey, District Court, 2d Judicial Cir.).

(h) Each Original Participating Manufacturer will establish an index and other features to improve searchable access to the document images on its website, as set forth in Exhibit I.

(i) Within 90 days after the MSA Execution Date, the Original Participating Manufacturers will furnish NAAG with a project plan for completing the Original Participating Manufacturers' obligations under subsection IV(h) with respect to documents currently on their websites and documents being placed on their websites pursuant to subsection IV(d). NAAG may engage a computer consultant at the Original Participating Manufacturers' expense for a period not to exceed two years and at a cost not to exceed $100,000. NAAG's computer consultant may review such plan and make recommendations consistent with this Agreement. In addition, within 120 days after the completion of the Original Participating Manufacturers' obligations under subsection IV(d), NAAG's computer consultant may make final recommendations with respect to the websites consistent with this Agreement. In preparing these recommendations, NAAG's computer consultant may seek input from Settling State officials, public health organizations and other users of the websites.

(j) The expenses incurred pursuant to subsection IV(i), and the expenses related to documents of the Tobacco-Related Organizations, will be severally shared among the Original Participating Manufacturers (allocated among them according to their Relative Market Shares). All other expenses incurred under this section will be borne by the Original Participating Manufacturer that incurs such expense.

V. TOBACCO CONTROL AND UNDERAGE USE LAWS

Each Participating Manufacturer agrees that following State-Specific Finality in a Settling State it will not initiate, or cause to be initiated, a facial challenge against the enforceability or constitutionality of such Settling State's (or such Settling State's political subdivisions') statutes, ordinances and administrative rules relating to tobacco control enacted prior to June 1, 1998 (other than a statute, ordinance or rule challenged in any lawsuit listed in Exhibit M).

VI. ESTABLISHMENT OF A NATIONAL FOUNDATION

(a) Foundation Purposes. The Settling States believe that a comprehensive, coordinated program of public education and study is important to further the remedial goals of this Agreement. Accordingly, as part of the settlement of claims described herein, the payments specified in subsections VI(b), VI(c), and IX(e) shall be made to a charitable foundation, trust or similar organization (the "Foundation") and/or to a program to be operated within the Foundation (the "National Public Education Fund"). The purposes of the Foundation will be to support (1) the study of and programs to reduce Youth Tobacco Product usage and Youth substance abuse in the States, and (2) the study of and educational programs to prevent diseases associated with the use of Tobacco Products in the States.

(b) Base Foundation Payments. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each Original Participating Manufacturer shall severally pay its Relative Market Share of $25,000,000 to fund the Foundation. The payments to be made by each of the Original Participating Manufacturers pursuant to this subsection (b) shall be subject to no adjustments, reductions, or offsets, and shall be paid to the Escrow Agent (to be credited to the Subsection VI(b) Account), who shall disburse such payments to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State.

(c) National Public Education Fund Payments.

(1) Each Original Participating Manufacturer shall severally pay its Relative Market Share of the following base amounts on the following dates to the Escrow Agent for the benefit of the Foundation's National Public Education Fund to be used for the purposes and as described in subsections VI(f)(1), VI(g) and VI(h) below: $250,000,000 on March 31, 1999; $300,000,000 on March 31, 2000; $300,000,000 on March 31, 2001; $300,000,000 on March 31, 2002; and $300,000,000 on March 31, 2003, as such amounts are modified in accordance with this subsection (c). The payment due on March 31, 1999 pursuant to this subsection (c)(1) is to be credited to the Subsection VI(c) Account (First). The payments due on or after March 31, 2000 pursuant to this subsection VI(c)(1) are to be credited to the Subsection VI(c) Account (Subsequent).

(2) The payments to be made by the Original Participating Manufacturers pursuant to this subsection (c), other than the payment due on March 31, 1999, shall be subject to the Inflation Adjustment, the Volume Adjustment and the offset for miscalculated or disputed payments described in subsection XI(i).

(3) The payment made pursuant to this subsection (c) on March 31, 1999 shall be disbursed by the Escrow Agent to the Foundation only upon the occurrence of State-Specific Finality in at least one Settling State. Each remaining payment pursuant to this subsection (c) shall be disbursed by the Escrow Agent to the Foundation only when State-Specific Finality has occurred in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date.

(4) In addition to the payments made pursuant to this subsection (c), the National Public Education Fund will be funded (A) in accordance with subsection IX(e), and (B) through monies contributed by other entities directly to the Foundation and designated for the National Public Education Fund ("National Public Education Fund Contributions").

(5) The payments made by the Original Participating Manufacturers pursuant to this subsection (c) and/or subsection IX(e) and monies received from all National Public Education Fund Contributions will be deposited and invested in accordance with the laws of the state of incorporation of the Foundation.

(d) Creation and Organization of the Foundation. NAAG, through its executive committee, will provide for the creation of the Foundation. The Foundation shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Internal Revenue Code section 501(c)(3). The organizational documents of the Foundation shall specifically incorporate the provisions of this Agreement relating to the Foundation, and will provide for payment of the Foundation's administrative expenses from the funds paid pursuant to subsection VI(b) or VI(c). The Foundation shall be governed by a board of directors. The board of directors shall be comprised of eleven directors. NAAG, the National Governors' Association ("NGA"), and the National Conference of State Legislatures ("NCSL") shall each select from its membership two directors. These six directors shall select the five additional directors. One of these five additional directors shall have expertise in public health issues. Four of these five additional directors shall have expertise in medical, child psychology, or public health disciplines. The board of directors shall be nationally geographically diverse.

(e) Foundation Affiliation. The Foundation shall be formally affiliated with an educational or medical institution selected by the board of directors.

(f) Foundation Functions. The functions of the Foundation shall be:

(1) carrying out a nationwide sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products;

(2) developing and disseminating model advertising and education programs to counter the use by Youth of substances that are unlawful for use or purchase by Youth, with an emphasis on reducing Youth smoking; monitoring and testing the effectiveness of such model programs; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs, as appropriate;

(3) developing and disseminating model classroom education programs and curriculum ideas about smoking and substance abuse in the K-12 school system, including specific target programs for special at-risk populations; monitoring and testing the effectiveness of such model programs and ideas; and, based on the information received from such monitoring and testing, continuing to develop and disseminate revised versions of such model programs or ideas, as appropriate;

(4) developing and disseminating criteria for effective cessation programs; monitoring and testing the effectiveness of such criteria; and continuing to develop and disseminate revised versions of such criteria, as appropriate;

(5) commissioning studies, funding research, and publishing reports on factors that influence Youth smoking and substance abuse and developing strategies to address the conclusions of such studies and research;

(6) developing other innovative Youth smoking and substance abuse prevention programs;

(7) providing targeted training and information for parents;

(8) maintaining a library open to the public of Foundation-funded studies, reports and other publications related to the cause and prevention of Youth smoking and substance abuse;

(9) tracking and monitoring Youth smoking and substance abuse, with a focus on the reasons for any increases or failures to decrease Youth smoking and substance abuse and what actions can be taken to reduce Youth smoking and substance abuse;

(10) receiving, controlling, and managing contributions from other entities to further the purposes described in this Agreement; and

(11) receiving, controlling, and managing such funds paid by the Participating Manufacturers pursuant to subsections VI(b) and VI(c) above.

(g) Foundation Grant-Making. The Foundation is authorized to make grants from the National Public Education Fund to Settling States and their political subdivisions to carry out sustained advertising and education programs to (1) counter the use by Youth of Tobacco Products, and (2) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products. In making such grants, the Foundation shall consider whether the Settling State or political subdivision applying for such grant:

(1) demonstrates the extent of the problem regarding Youth smoking in such Settling State or political subdivision;

(2) either seeks the grant to implement a model program developed by the Foundation or provides the Foundation with a specific plan for such applicant's intended use of the grant monies, including demonstrating such applicant's ability to develop an effective advertising/education campaign and to assess the effectiveness of such advertising/education campaign;

(3) has other funds readily available to carry out a sustained advertising and education program to (A) counter the use by Youth of Tobacco Products, and (B) educate consumers about the cause and prevention of diseases associated with the use of Tobacco Products; and

(4) is a Settling State that has not severed this section VI from its settlement with the Participating Manufacturers pursuant to subsection VI(i) below, or is a political subdivision in such a Settling State.

(h) Foundation Activities. The Foundation shall not engage in, nor shall any of the Foundation's money be used to engage in, any political activities or lobbying, including, but not limited to, support of or opposition to candidates, ballot initiatives, referenda or other similar activities. The National Public Education Fund shall be used only for public education and advertising regarding the addictiveness, health effects, and social costs related to the use of tobacco products and shall not be used for any personal attack on, or vilification of, any person (whether by name or business affiliation), company, or governmental agency, whether individually or collectively. The Foundation shall work to ensure that its activities are carried out in a culturally and linguistically appropriate manner. The Foundation's activities (including the National Public Education Fund) shall be carried out solely within the States. The payments described in subsections VI(b) and VI(c) above are made at the direction and on behalf of Settling States. By making such payments in such manner, the Participating Manufacturers do not undertake and expressly disclaim any responsibility with respect to the creation, operation, liabilities, or tax status of the Foundation or the National Public Education Fund.

(i) Severance of this Section. If the Attorney General of a Settling State determines that such Settling State may not lawfully enter into this section VI as a matter of applicable state law, such Attorney General may sever this section VI from its settlement with the Participating Manufacturers by giving written notice of such severance to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k) hereof. If any Settling State exercises its right to sever this section VI, this section VI shall not be considered a part of the specific settlement between such Settling State and the Participating Manufacturers, and this section VI shall not be enforceable by or in such Settling State. The payment obligation of subsections VI(b) and VI(c) hereof shall apply regardless of a determination by one or more Settling States to sever section VI hereof; provided, however, that if all Settling States sever section VI hereof, the payment obligations of subsections (b) and (c) hereof shall be null and void. If the Attorney General of a Settling State that severed this section VI subsequently determines that such Settling State may lawfully enter into this section VI as a matter of applicable state law, such Attorney General may rescind such Settling State's previous severance of this section VI by giving written notice of such rescission to each Participating Manufacturer and NAAG pursuant to subsection XVIII(k). If any Settling State rescinds such severance, this section VI shall be considered a part of the specific settlement between such Settling State and the Participating Manufacturers (including for purposes of subsection (g)(4)), and this section VI shall be enforceable by and in such Settling State.

VII. ENFORCEMENT

(a) Jurisdiction. Each Participating Manufacturer and each Settling State acknowledge that the Court: (1) has jurisdiction over the subject matter of the action identified in Exhibit D in such Settling State and over each Participating Manufacturer; (2) shall retain exclusive jurisdiction for the purposes of implementing and enforcing this Agreement and the

Consent Decree as to such Settling State; and (3) except as provided in subsections IX(d), XI(c) and XVII(d) and Exhibit O, shall be the only court to which disputes under this Agreement or the Consent Decree are presented as to such Settling State. Provided, however, that notwithstanding the foregoing, the Escrow Court (as defined in the Escrow Agreement) shall have exclusive jurisdiction, as provided in section 15 of the Escrow Agreement, over any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, the Escrow Agreement.

(b) Enforcement of Consent Decree. Except as expressly provided in the Consent Decree, any Settling State or Released Party may apply to the Court to enforce the terms of the Consent Decree (or for a declaration construing any such term) with respect to alleged violations within such Settling State. A Settling State may not seek to enforce the Consent Decree of another Settling State; provided, however, that nothing contained herein shall affect the ability of any Settling State to (1) coordinate state enforcement actions or proceedings, or (2) file or join any amicus brief. In the event that the Court determines that any Participating Manufacturer or Settling State has violated the Consent Decree within such Settling State, the party that initiated the proceedings may request any and all relief available within such Settling State pursuant to the Consent Decree.

(c) Enforcement of this Agreement.

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) Right of Review. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

(e) Applicability. This Agreement and the Consent Decree apply only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a breach or violation of this Agreement or the Consent Decree (or any Declaratory Order or Enforcement Order issued in connection with this Agreement or the Consent Decree) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach or violation, and the Court shall have no jurisdiction to do so.

(f) Coordination of Enforcement. The Attorneys General of the Settling States (through NAAG) shall monitor potential conflicting interpretations by courts of different States of this Agreement and the Consent Decrees. The Settling States

shall use their best efforts, in cooperation with the Participating Manufacturers, to coordinate and resolve the effects of such conflicting interpretations as to matters that are not exclusively local in nature.

(g) Inspection and Discovery Rights. Without limitation on whatever other rights to access they may be permitted by law, following State-Specific Finality in a Settling State and for seven years thereafter, representatives of the Attorney General of such Settling State may, for the purpose of enforcing this Agreement and the Consent Decree, upon reasonable cause to believe that a violation of this Agreement or the Consent Decree has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days): (1) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books, records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of each Participating Manufacturer insofar as they pertain to such believed violation; and (2) interview each Participating Manufacturer's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation. Documents and information provided to representatives of the Attorney General of such Settling State pursuant to this section VII shall be kept confidential by the Settling States, and shall be utilized only by the Settling States and only for purposes of enforcing this Agreement, the Consent Decree and the criminal law. The inspection and discovery rights provided to such Settling State pursuant to this subsection shall be coordinated through NAAG so as to avoid repetitive and excessive inspection and discovery.

VIII. CERTAIN ONGOING RESPONSIBILITIES OF THE SETTLING STATES

(a) Upon approval of the NAAG executive committee, NAAG will provide coordination and facilitation for the implementation and enforcement of this Agreement on behalf of the Attorneys General of the Settling States, including the following:

(1) NAAG will assist in coordinating the inspection and discovery activities referred to in subsections III(p)(3) and VII(g) regarding compliance with this Agreement by the Participating Manufacturers and any new tobacco-related trade associations.

(2) NAAG will convene at least two meetings per year and one major national conference every three years for the Attorneys General of the Settling States, the directors of the Foundation and three persons designated by each Participating Manufacturer. The purpose of the meetings and conference is to evaluate the success of this Agreement and coordinate efforts by the Attorneys General and the Participating Manufacturers to continue to reduce Youth smoking.

(3) NAAG will periodically inform NGA, NCSL, the National Association of Counties and the National League of Cities of the results of the meetings and conferences referred to in subsection (a)(2) above.

(4) NAAG will support and coordinate the efforts of the Attorneys General of the Settling States in carrying out their responsibilities under this Agreement.

(5) NAAG will perform the other functions specified for it in this Agreement, including the functions specified in section IV.

(b) Upon approval by the NAAG executive committee to assume the responsibilities outlined in subsection VIII(a) hereof, each Original Participating Manufacturer shall cause to be paid, beginning on December 31, 1998, and on December 31 of each year thereafter through and including December 31, 2007, its Relative Market Share of $150,000 per year to the Escrow Agent (to be credited to the Subsection VIII(b) Account), who shall disburse such monies to NAAG within 10 Business Days, to fund the activities described in subsection VIII(a).

(c) The Attorneys General of the Settling States, acting through NAAG, shall establish a fund ("The States' Antitrust/Consumer Protection Tobacco Enforcement Fund") in the form attached as Exhibit J, which will be maintained by such Attorneys General to supplement the Settling States' (1) enforcement and implementation of the terms of this Agreement and the Consent Decrees, and (2) investigation and litigation of potential violations of laws with respect to Tobacco Products, as set forth in Exhibit J. Each Original Participating Manufacturer shall on March 31, 1999, severally pay its Relative Market Share of $50,000,000 to the Escrow Agent (to be credited to the Subsection VIII(c) Account), who shall disburse such monies to NAAG upon the occurrence of State-Specific Finality in at least one Settling State. Such funds will be used in accordance with the provisions of Exhibit J.

IX. PAYMENTS

(a) All Payments Into Escrow. All payments made pursuant to this Agreement (except those payments made pursuant to section XVII) shall be made into escrow pursuant to the Escrow Agreement, and shall be credited to the appropriate Account

established pursuant to the Escrow Agreement. Such payments shall be disbursed to the beneficiaries or returned to the Participating Manufacturers only as provided in section XI and the Escrow Agreement. No payment obligation under this Agreement shall arise (1) unless and until the Escrow Court has approved and retained jurisdiction over the Escrow Agreement or (2) if such approval is reversed (unless and until such reversal is itself reversed). The parties agree to proceed as expeditiously as possible to resolve any issues that prevent approval of the Escrow Agreement. If any payment (other than the first initial payment under subsection IX(b)) is delayed because the Escrow Agreement has not been approved, such payment shall be due and payable (together with interest at the Prime Rate) within 10 Business Days after approval of the Escrow Agreement by the Escrow Court.

(b) Initial Payments. On the second Business Day after the Escrow Court approves and retains jurisdiction over the Escrow Agreement, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(b) Account (First)) its Market Capitalization Percentage (as set forth in Exhibit K) of the base amount of $2,400,000,000. On January 10, 2000, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,472,000,000. On January 10, 2001, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,546,160,000. On January 10, 2002, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,622,544,800. On January 10, 2003, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,701,221,144. The payments pursuant to this subsection (b) due on or after January 10, 2000 shall be credited to the Subsection IX(b) Account (Subsequent). The foregoing payments shall be modified in accordance with this subsection (b). The payments made by the Original Participating Manufacturers pursuant to this subsection (b) (other than the first such payment) shall be subject to the Volume Adjustment, the Non-Settling States Reduction and the offset for miscalculated or disputed payments described in subsection XI(i). The first payment due under this subsection (b) shall be subject to the Non-Settling States Reduction, but such reduction shall be determined as of the date one day before such payment is due (rather than the date 15 days before).

(c) Annual Payments and Strategic Contribution Payments.

(1) On April 15, 2000 and on April 15 of each year thereafter in perpetuity, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(1) Account) its Relative Market Share of the base amounts specified below, as such payments are modified in accordance with this subsection (c)(1):

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

The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(1) shall be subject to the Inflation Adjustment, the Volume Adjustment, the Previously Settled States Reduction, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8).

(2) On April 15, 2008 and on April 15 of each year thereafter through 2017, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(2) Account) its Relative Market Share of the base amount of $861,000,000, as such payments are modified in accordance with this subsection (c)(2). The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2) (and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) Non-Participating Manufacturer Adjustment.

(1) Calculation of NPM Adjustment for Original Participating Manufacturers. To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (*1*) the Variable Multiplier and (*2*) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the

year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting through a principal or principals acceptable to such parties, if such a person can be identified and, if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

(2) Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their respective Allocable Shares, and such other Settling States' Allocated Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any

individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of (*1*) its Base NPM Adjustment for such year, and (*2*) the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then (*1*) such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and (*2*) such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by

(y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of (*1*) 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or (*2*) 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

(iii) In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) Supplemental Payments. Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the

entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) Payment Responsibility. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) Corporate Structures. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) Accrual of Interest. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) Payments by Subsequent Participating Manufacturers.

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of (*1*) its 1998 Market Share or (*2*) 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufacturer shall make payments corresponding to those due in that same following year from the Original Participating Manufacturers pursuant to subsections VI(c) (except for the payment due on March 31, 1999), IX(c)(1), IX(c)(2) and IX(e). The amounts of such corresponding payments by a Subsequent Participating Manufacturer are in addition to the corresponding payments that are due from the Original Participating Manufacturers and shall be determined as described in subsections (2) and (3) below. Such payments by a Subsequent Participating Manufacturer shall (A) be due on the same dates as the corresponding payments are due from Original Participating Manufacturers; (B) be for the same purpose as such corresponding payments; and (C) be paid, allocated and distributed in the same manner as such corresponding payments.

(2) The base amount due from a Subsequent Participating Manufacturer on any given date shall be determined by multiplying (A) the corresponding base amount due on the same date from all of the Original Participating Manufacturers (as such base amount is specified in the corresponding subsection of this Agreement and is adjusted by the Volume Adjustment (except for the provisions of subsection (B)(ii) of Exhibit E), but before such base amount is modified by any other adjustments, reductions or offsets) by (B) the quotient produced by dividing (i) the result of (x) such Subsequent Participating Manufacturer's applicable Market Share (the applicable Market Share being that for the calendar year immediately preceding the year in which the payment in question is due) minus (y) the greater of (*1*) its 1998 Market Share or (*2*) 125 percent of its 1997 Market Share, by (ii) the aggregate Market Shares of the Original Participating Manufacturers (the applicable Market Shares being those for the calendar year immediately preceding the year in which the payment in question is due).

(3) Any payment due from a Subsequent Participating Manufacturer under subsections (1) and (2) above shall be subject (up to the full amount of such payment) to the Inflation Adjustment, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8), to the extent that such adjustments, reductions or offsets would apply to the corresponding payment due from the Original Participating Manufacturers. Provided, however, that all adjustments and offsets to which a Subsequent Participating

Manufacturer is entitled may only be applied against payments by such Subsequent Participating Manufacturer, if any, that are due within 12 months after the date on which the Subsequent Participating Manufacturer becomes entitled to such adjustment or makes the payment that entitles it to such offset, and shall not be carried forward beyond that time even if not fully used.

(4) For purposes of this subsection (i), the 1997 (or 1998, as applicable) Market Share (and 125 percent thereof) of those Subsequent Participating Manufacturers that either (A) became a signatory to this Agreement more than 60 days after the MSA Execution Date or (B) had no Market Share in 1997 (or 1998, as applicable), shall equal zero.

(j) Order of Application of Allocations, Offsets, Reductions and Adjustments. The payments due under this Agreement shall be calculated as set forth below. The "base amount" referred to in clause "First" below shall mean (1) in the case of payments due from Original Participating Manufacturers, the base amount referred to in the subsection establishing the payment obligation in question; and (2) in the case of payments due from a Subsequent Participating Manufacturer, the base amount referred to in subsection (i)(2) for such Subsequent Participating Manufacturer. In the event that a particular adjustment, reduction or offset referred to in a clause below does not apply to the payment being calculated, the result of the clause in question shall be deemed to be equal to the result of the immediately preceding clause. (If clause "First" is inapplicable, the result of clause "First" will be the base amount of the payment in question prior to any offsets, reductions or adjustments.)

First: the Inflation Adjustment shall be applied to the base amount of the payment being calculated;

Second: the Volume Adjustment (other than the provisions of subsection (B)(iii) of Exhibit E) shall be applied to the result of clause "First";

Third: the result of clause "Second" shall be reduced by the Previously Settled States Reduction;

Fourth: the result of clause "Third" shall be reduced by the Non-Settling States Reduction;

Fifth: in the case of payments due under subsections IX(c)(1) and IX(c)(2), the results of clause "Fourth" for each such payment due in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together to form such Settling State's Allocated Payment. In the case of payments due under subsection IX(i) that correspond to payments due under subsections IX(c)(1) or IX(c)(2), the results of clause "Fourth" for all such payments due from a particular Subsequent Participating Manufacturer in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together. (In the case of all other payments made pursuant to this Agreement, this clause "Fifth" is inapplicable.);

Sixth: the NPM Adjustment shall be applied to the results of clause "Fifth" pursuant to subsections IX(d)(1) and (d)(2) (or, in the case of payments due from the Subsequent Participating Manufacturers, pursuant to subsection IX(d)(4));

Seventh: in the case of payments due from the Original Participating Manufacturers to which clause "Fifth" (and therefore clause "Sixth") does not apply, the result of clause "Fourth" shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares. In the case of payments due from the Original Participating Manufacturers to which clause "Fifth" applies: (A) the Allocated Payments of all Settling States determined pursuant to clause "Fifth" (prior to reduction pursuant to clause "Sixth") shall be added together; (B) the resulting sum shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares and subsection (B)(iii) of Exhibit E hereto (if such subsection is applicable); (C) the Available NPM Adjustment (as determined pursuant to clause "Sixth") shall be allocated among the Original Participating Manufacturers pursuant to subsection IX(d)(3); (D) the respective result of step (C) above for each Original Participating Manufacturer shall be subtracted from the respective result of step (B) above for such Original Participating Manufacturer; and (E) the resulting payment amount due from each Original Participating Manufacturer shall then be allocated among the Settling States in proportion to the respective results of clause "Sixth" for each Settling State. The offsets described in clauses "Eighth" through "Twelfth" shall then be applied separately against each Original Participating Manufacturer's resulting payment shares (on a Settling State by Settling State basis) according to each Original Participating Manufacturer's separate entitlement to such offsets, if any, in the calendar year in question. (In the case of payments due from Subsequent Participating Manufacturers, this clause "Seventh" is inapplicable.)

Eighth: the offset for miscalculated or disputed payments described in subsection XI(i) (and any carry-forwards arising from such offset) shall be applied to the results of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or to the results of clause "Sixth" (in the case of payments due from Subsequent Participating Manufacturers);

Ninth: the Federal Tobacco Legislation Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eighth";

Tenth: the Litigating Releasing Parties Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Ninth";

Eleventh: the offset for claims over pursuant to subsection XII(a)(4)(B) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Tenth";

Twelfth: the offset for claims over pursuant to subsection XII(a)(8) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eleventh"; and

Thirteenth: in the case of payments to which clause "Fifth" applies, the Settling States' allocated shares of the payments due from each Participating Manufacturer (as such shares have been determined in step (E) of clause "Seventh" in the case of payments from the Original Participating Manufacturers or in clause "Sixth" in the case of payments from the Subsequent Participating Manufacturers, and have been reduced by clauses "Eighth" through "Twelfth") shall be added together to state the aggregate payment obligation of each Participating Manufacturer with respect to the payments in question. (In the case of a payment to which clause "Fifth" does not apply, the aggregate payment obligation of each Participating Manufacturer with respect to the payment in question shall be stated by the results of clause "Eighth.")

X. EFFECT OF FEDERAL TOBACCO-RELATED LEGISLATION

(a) If federal tobacco-related legislation is enacted after the MSA Execution Date and on or before November 30, 2002, and if such legislation provides for payment(s) by any Original Participating Manufacturer (whether by settlement payment, tax or any other means), all or part of which are actually made available to a Settling State ("Federal Funds"), each Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any and all amounts that are paid by such Original Participating Manufacturer pursuant to such legislation and actually made available to such Settling State (except as described in subsections (b) and (c) below). Such offset shall be applied against the applicable Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of such Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment and has been reduced by offset, if any, pursuant to the offset for miscalculated or disputed payments). Such offset shall be made against such Original Participating Manufacturer's share of the first Allocated Payment due after such Federal Funds are first available for receipt by such Settling State. In the event that such offset would in any given year exceed such Original Participating Manufacturer's share of such Allocated Payment: (1) the offset to which such Original Participating Manufacturer is entitled under this section in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment, and (2) all amounts not offset by reason of subsection (1) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(b) The offset described in subsection (a) shall apply only to that portion of Federal Funds, if any, that are either unrestricted as to their use, or restricted to any form of health care or to any use related to tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) (other than that portion of Federal Funds, if any, that is specifically applicable to tobacco growers or communities dependent on the production of tobacco or Tobacco Products). Provided, however, that the offset described in subsection (a) shall not apply to that portion of Federal Funds, if any, whose receipt by such Settling State is conditioned upon or appropriately allocable to:

(1) the relinquishment of rights or benefits under this Agreement (including the Consent Decree); or

(2) actions or expenditures by such Settling State, unless:

(A) such Settling State chooses to undertake such action or expenditure;

(B) such actions or expenditures do not impose significant constraints on public policy choices; or

(C) such actions or expenditures are both: (i) related to health care or tobacco (including, but not limited to, tobacco education, cessation, control or enforcement) and (ii) do not require such Settling State to expend state matching funds in an amount that is significant in relation to the amount of the Federal Funds made available to such Settling State.

(c) Subject to the provisions of subsection IX(i)(3), Subsequent Participating Manufacturers shall be entitled to the offset described in this section X to the extent that they are required to pay Federal Funds that would give rise to an offset under subsections (a) and (b) if paid by an Original Participating Manufacturer.

(d) Nothing in this section X shall (1) reduce the payments to be made to the Settling States under this Agreement other than those described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement; or (2) alter the Allocable Share used to determine each Settling State's share of the payments described in subsection IX(c) (or corresponding payments under subsection IX(i)) of this Agreement. Nothing in this section X is intended to or shall reduce the total amounts payable by the Participating Manufacturers to the Settling States under this Agreement by an amount greater than the amount of Federal Funds that the Settling States could elect to receive.

XI. CALCULATION AND DISBURSEMENT OF PAYMENTS

(a) Independent Auditor to Make All Calculations.

(1) Beginning with payments due in the year 2000, an Independent Auditor shall calculate and determine the amount of all payments owed pursuant to this Agreement, the adjustments, reductions and offsets thereto (and all resulting carry-forwards, if any), the allocation of such payments, adjustments, reductions, offsets and carry-forwards among the Participating Manufacturers and among the Settling States, and shall perform all other calculations in connection with the foregoing (including, but not limited to, determining Market Share, Relative Market Share, Base Aggregate Participating Manufacturer Market Share and Actual Aggregate Participating Manufacturer Market Share). The Independent Auditor shall promptly collect all information necessary to make such calculations and determinations. Each Participating Manufacturer and each Settling State shall provide the Independent Auditor, as promptly as practicable, with information in its possession or readily available to it necessary for the Independent Auditor to perform such calculations. The Independent Auditor shall agree to maintain the confidentiality of all such information, except that the Independent Auditor may provide such information to Participating Manufacturers and the Settling States as set forth in this Agreement. The Participating Manufacturers and the Settling States agree to maintain the confidentiality of such information.

(2) Payments due from the Original Participating Manufacturers prior to January 1, 2000 (other than the first payment due pursuant to subsection IX(b)) shall be based on the 1998 Relative Market Shares of the Original Participating Manufacturers or, if the Original Participating Manufacturers are unable to agree on such Relative Market Shares, on their 1997 Relative Market Shares specified in Exhibit Q.

(b) Identity of Independent Auditor. The Independent Auditor shall be a major, nationally recognized, certified public accounting firm jointly selected by agreement of the Original Participating Manufacturers and those Attorneys General of the Settling States who are members of the NAAG executive committee, who shall jointly retain the power to replace the Independent Auditor and appoint its successor. Fifty percent of the costs and fees of the Independent Auditor (but in no event more than $500,000 per annum), shall be paid by the Fund described in Exhibit J hereto, and the balance of such costs and fees shall be paid by the Original Participating Manufacturers, allocated among them according to their Relative Market Shares. The agreement retaining the Independent Auditor shall provide that the Independent Auditor shall perform the functions specified for it in this Agreement, and that it shall do so in the manner specified in this Agreement.

(c) Resolution of Disputes. Any dispute, controversy or claim arising out of or relating to calculations performed by, or any determinations made by, the Independent Auditor (including, without limitation, any dispute concerning the operation or application of any of the adjustments, reductions, offsets, carry-forwards and allocations described in subsection IX(j) or subsection XI(i)) shall be submitted to binding arbitration before a panel of three neutral arbitrators, each of whom shall be a former Article III federal judge. Each of the two sides to the dispute shall select one arbitrator. The two arbitrators so selected shall select the third arbitrator. The arbitration shall be governed by the United States Federal Arbitration Act.

(d) General Provisions as to Calculation of Payments.

(1) Not less than 90 days prior to the scheduled due date of any payment due pursuant to this Agreement ("Payment Due Date"), the Independent Auditor shall deliver to each other Notice Party a detailed itemization of all information required by the Independent Auditor to complete its calculation of (A) the amount due from each Participating Manufacturer with respect to such payment, and (B) the portion of such amount allocable to each entity for whose benefit such payment is to be made. To the extent practicable, the Independent Auditor shall specify in such itemization which Notice Party is requested to produce which information. Each Participating Manufacturer and each Settling State shall use its best efforts to promptly supply all of the required information that is within its possession or is readily available to it to the Independent Auditor, and in any event not less than 50 days prior to such Payment Due Date. Such best efforts obligation shall be continuing in the case of information that comes within the possession of, or becomes readily available to, any Settling State or Participating Manufacturer after the date 50 days prior to such Payment Due Date.

(2) Not less than 40 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party (A) detailed preliminary calculations ("Preliminary Calculations") of the amount due from each Participating Manufacturer and of the amount allocable to each entity for whose benefit such payment is to be made, showing all applicable offsets, adjustments, reductions and carry-forwards and setting forth all the information on which the Independent Auditor relied in preparing such Preliminary Calculations, and (B) a statement of any information still required by the Independent Auditor to complete its calculations.

(3) Not less than 30 days prior to the Payment Due Date, any Participating Manufacturer or any Settling State that disputes any aspect of the Preliminary Calculations (including, but not limited to, disputing the methodology that the Independent Auditor employed, or the information on which the Independent Auditor relied, in preparing such calculations) shall notify each other Notice Party of such dispute, including the reasons and basis therefor.

(4) Not less than 15 days prior to the Payment Due Date, the Independent Auditor shall deliver to each other Notice Party a detailed recalculation (a "Final Calculation") of the amount due from each Participating Manufacturer, the amount allocable to each entity for whose benefit such payment is to be made, and the Account to which such payment is to be credited, explaining any changes from the Preliminary Calculation. The Final Calculation may include estimates of amounts in the circumstances described in subsection (d)(5).

(5) The following provisions shall govern in the event that the information required by the Independent Auditor to complete its calculations is not in its possession by the date as of which the Independent Auditor is required to provide either a Preliminary Calculation or a Final Calculation.

(A) If the information in question is not readily available to any Settling State, any Original Participating Manufacturer or any Subsequent Participating Manufacturer, the Independent Auditor shall employ an assumption as to the missing information producing the minimum amount that is likely to be due with respect to the payment in question, and shall set forth its assumption as to the missing information in its Preliminary Calculation or Final Calculation, whichever is at issue. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State may dispute any such assumption employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or any such assumption employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the missing information becomes available to the Independent Auditor prior to the Payment Due Date, the Independent Auditor shall promptly revise its Preliminary Calculation or Final Calculation (whichever is applicable) and shall promptly provide the revised calculation to each Notice Party, showing the newly available information. If the missing information does not become available to the Independent Auditor prior to the Payment Due Date, the minimum amount calculated by the Independent Auditor pursuant to this subsection (A) shall be paid on the Payment Due Date, subject to disputes pursuant to subsections (d)(6) and (d)(8) and without prejudice to a later final determination of the correct amount. If the missing information becomes available to the Independent Auditor after the Payment Due Date, the Independent Auditor shall calculate the correct amount of the payment in question and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(B) If the information in question is readily available to a Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer, but such Settling State, Original Participating Manufacturer or Subsequent Participating Manufacturer does not supply such information to the Independent Auditor, the Independent Auditor shall base the calculation in question on its best estimate of such information, and shall show such estimate in its Preliminary Calculation or Final Calculation, whichever is applicable. Any Original Participating Manufacturer, Subsequent Participating Manufacturer or Settling State (except the entity that withheld the information) may dispute such estimate employed by the Independent Auditor in its Preliminary Calculation in the manner prescribed in subsection (d)(3) or such estimate employed by the Independent Auditor in its Final Calculation in the manner prescribed in subsection (d)(6). If the withheld information is not made available to the Independent Auditor more than 30 days prior to the Payment Due Date, the estimate employed by the Independent Auditor (as revised by the Independent Auditor in light of any dispute filed pursuant to the preceding sentence) shall govern the amounts to be paid on the Payment Due Date, subject to disputes pursuant to subsection (d)(6) and without prejudice to a later final determination of the correct amount. In the event that the withheld information subsequently becomes available, the Independent Auditor shall calculate the correct amount and shall apply any overpayment or underpayment as an offset or additional payment in the manner described in subsection (i).

(6) Not less than five days prior to the Payment Due Date, each Participating Manufacturer and each Settling State shall deliver to each Notice Party a statement indicating whether it disputes the Independent Auditor's Final Calculation and, if so, the disputed and undisputed amounts and the basis for the dispute. Except to the extent a Participating Manufacturer or a Settling State delivers a statement indicating the existence of a dispute by such date, the amounts set forth in

the Independent Auditor's Final Calculation shall be paid on the Payment Due Date. Provided, however, that (A) in the event that the Independent Auditor revises its Final Calculation within five days of the Payment Due Date as provided in subsection (5)(A) due to receipt of previously missing information, a Participating Manufacturer or Settling State may dispute such revision pursuant to the procedure set forth in this subsection (6) at any time prior to the Payment Due Date; and (B) prior to the date four years after the Payment Due Date, neither failure to dispute a calculation made by the Independent Auditor nor actual agreement with any calculation or payment to the Escrow Agent or to another payee shall waive any Participating Manufacturer's or Settling State's rights to dispute any payment (or the Independent Auditor's calculations with respect to any payment) after the Payment Due Date. No Participating Manufacturer and no Settling State shall have a right to raise any dispute with respect to any payment or calculation after the date four years after such payment's Payment Due Date.

(7) Each Participating Manufacturer shall be obligated to pay by the Payment Due Date the undisputed portion of the total amount calculated as due from it by the Independent Auditor's Final Calculation. Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h) of this Agreement, in addition to any other remedy available under this Agreement.

(8) As to any disputed portion of the total amount calculated to be due pursuant to the Final Calculation, any Participating Manufacturer that by the Payment Due Date pays such disputed portion into the Disputed Payments Account (as defined in the Escrow Agreement) shall not be liable for interest thereon even if the amount disputed was in fact properly due and owing. Any Participating Manufacturer that by the Payment Due Date does not pay such disputed portion into the Disputed Payments Account shall be liable for interest as provided in subsection IX(h) if the amount disputed was in fact properly due and owing.

(9) On the same date that it makes any payment pursuant to this Agreement, each Participating Manufacturer shall deliver a notice to each other Notice Party showing the amount of such payment and the Account to which such payment is to be credited.

(10) On the first Business Day after the Payment Due Date, the Escrow Agent shall deliver to each other Notice Party a statement showing the amounts received by it from each Participating Manufacturer and the Accounts credited with such amounts.

(e) General Treatment of Payments. The Escrow Agent may disburse amounts from an Account only if permitted, and only at such time as permitted, by this Agreement and the Escrow Agreement. No amounts may be disbursed to a Settling State other than funds credited to such Settling State's State-Specific Account (as defined in the Escrow Agreement). The Independent Auditor, in delivering payment instructions to the Escrow Agent, shall specify: the amount to be paid; the Account or Accounts from which such payment is to be disbursed; the payee of such payment (which may be an Account); and the Business Day on which such payment is to be made by the Escrow Agent. Except as expressly provided in subsection (f) below, in no event may any amount be disbursed from any Account prior to Final Approval.

(f) Disbursements and Charges Not Contingent on Final Approval. Funds may be disbursed from Accounts without regard to the occurrence of Final Approval in the following circumstances and in the following manner:

(1) Payments of Federal and State Taxes. Federal, state, local or other taxes imposed with respect to the amounts credited to the Accounts shall be paid from such amounts. The Independent Auditor shall prepare and file any tax returns required to be filed with respect to the escrow. All taxes required to be paid shall be allocated to and charged against the Accounts on a reasonable basis to be determined by the Independent Auditor. Upon receipt of written instructions from the Independent Auditor, the Escrow Agent shall pay such taxes and charge such payments against the Account or Accounts specified in those instructions.

(2) Payments to and from Disputed Payments Account. The Independent Auditor shall instruct the Escrow Agent to credit funds from an Account to the Disputed Payments Account when a dispute arises as to such funds, and shall instruct the Escrow Agent to credit funds from the Disputed Payments Account to the appropriate payee when such dispute is resolved with finality. The Independent Auditor shall provide the Notice Parties not less than 10 Business Days prior notice before instructing the Escrow Agent to disburse funds from the Disputed Payments Account.

(3) Payments to a State-Specific Account. Promptly following the occurrence of State-Specific Finality in any Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such State-Specific Finality and of the portions of the amounts in the Subsection IX(b) Account (First), Subsection IX(b) Account (Subsequent), Subsection IX(c)(1) Account and Subsection IX(c)(2) Account, respectively (as such Accounts are defined in the Escrow Agreement), that are at such

time held in such Accounts for the benefit of such Settling State, and which are to be transferred to the appropriate State-Specific Account for such Settling State. If neither the Settling State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to make such transfer. If the Settling State in question or any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (f)(3), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and the undisputed portion to the appropriate State-Specific Account. No amounts may be transferred or credited to a State-Specific Account for the benefit of any State as to which State-Specific Finality has not occurred or as to which this Agreement has terminated.

(4) Payments to Parties other than Particular Settling States.

(A) Promptly following the occurrence of State-Specific Finality in one Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of State-Specific Finality in at least one Settling State and of the amounts held in the Subsection VI(b) Account, Subsection VI(c) Account (First), and Subsection VIII(c) Account (as such Accounts are defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of State-Specific Finality in one Settling State, by notice delivered to each Notice Party not later than ten Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Accounts to the Foundation or to the Fund specified in subsection VIII(c), as appropriate. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(A), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation or to the Fund specified in subsection VIII(c), as appropriate.

(B) The Independent Auditor shall instruct the Escrow Agent to disburse funds on deposit in the Subsection VIII(b) Account and Subsection IX(e) Account (as such Accounts are defined in the Escrow Agreement) to NAAG or to the Foundation, as appropriate, within 10 Business Days after the date on which such amounts were credited to such Accounts.

(C) Promptly following the occurrence of State-Specific Finality in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of such State-Specific Finality and of the amounts held in the Subsection VI(c) Account (Subsequent) (as such Account is defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of such State-Specific Finality, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Account to the Foundation. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation.

(5) Treatment of Payments Following Termination.

(A) As to amounts held for Settling States. Promptly upon the termination of this Agreement with respect to any Settling State (whether or not as part of the termination of this Agreement as to all Settling States) such State or any Participating Manufacturer shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, the Subsection IX(c)(2) Account, and the State-Specific Account for the benefit of such Settling State. If neither the State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent

Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If the State in question or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(A), the Independent Auditor shall promptly instruct the Escrow Agent to transfer the amount disputed to the Disputed Payments Account and the undisputed portion to the Participating Manufacturers (on the basis of their respective contributions of such funds).

(B) As to amounts held for others. If this Agreement is terminated with respect to all of the Settling States, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(b) Account, the Subsection VI(c) Account (First), the Subsection VIII(b) Account, the Subsection VIII(c) Account and the Subsection IX(e) Account. If neither any such State nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(B), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(C) As to amounts held in the Subsection VI(c) Account (Subsequent). If this Agreement is terminated with respect to Settling States having aggregate Allocable Shares equal to more than 20% of the total aggregate Allocable Shares assigned to those States that were Settling States as of the MSA Execution Date, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(c) Account (Subsequent) (as defined in the Escrow Agreement). If neither any such State with respect to which this Agreement has terminated nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Account or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(6) Determination of amounts paid or held for the benefit of each individual Settling State. For purposes of subsections (f)(3), (f)(5)(A) and (i)(2), the portion of a payment that is made or held for the benefit of each individual Settling State shall be determined: (A) in the case of a payment credited to the Subsection IX(b) Account (First) or the Subsection IX(b) Account (Subsequent), by allocating the results of clause "Eighth" of subsection IX(j) among those Settling States who were Settling States at the time that the amount of such payment was calculated, pro rata in proportion to their respective Allocable Shares; and (B) in the case of a payment credited to the Subsection IX(c)(1) Account or the Subsection IX(c)(2) Account, by the results of clause "Twelfth" of subsection IX(j) for each individual Settling State. Provided, however, that, solely for purposes of subsection (f)(3), the Settling States may by unanimous agreement agree on a different method of allocation of amounts held in the Accounts identified in this subsection (f)(6).

(g) Payments to be Made Only After Final Approval. Promptly following the occurrence of Final Approval, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of Final Approval and of the amounts held in the State-Specific Accounts. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts, disputes the occurrence of Final Approval or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in the State-Specific Accounts to (or as directed by) the respective Settling States. If any Notice Party disputes such amounts or the occurrence of Final Approval, or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each other Notice Party

not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to (or as directed by) the respective Settling States.

(h) Applicability to Section XVII Payments. This section XI shall not be applicable to payments made pursuant to section XVII; provided, however, that the Independent Auditor shall be responsible for calculating Relative Market Shares in connection with such payments, and the Independent Auditor shall promptly provide the results of such calculation to any Original Participating Manufacturer or Settling State that requests it do so.

(i) Miscalculated or Disputed Payments.

(1) Underpayments.

(A) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date, and such information shows that any Participating Manufacturer was instructed to make an insufficient payment on such date ("original payment"), the Independent Auditor shall promptly determine the additional payment owed by such Participating Manufacturer and the allocation of such additional payment among the applicable payees. The Independent Auditor shall then reduce such additional payment (up to the full amount of such additional payment) by any adjustments or offsets that were available to the Participating Manufacturer in question against the original payment at the time it was made (and have not since been used) but which such Participating Manufacturer was unable to use against such original payment because such adjustments or offsets were in excess of such original payment (provided that any adjustments or offsets used against such additional payment shall reduce on a dollar-for-dollar basis any remaining carry-forward held by such Participating Manufacturer with respect to such adjustment or offset). The Independent Auditor shall then add interest at the Prime Rate (calculated from the Payment Due Date in question) to the additional payment (as reduced pursuant to the preceding sentence), except that where the additional payment owed by a Participating Manufacturer is the result of an underpayment by such Participating Manufacturer caused by such Participating Manufacturer's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h). The Independent Auditor shall promptly give notice of the additional payment owed by the Participating Manufacturer in question (as reduced and/or increased as described above) to all Notice Parties, showing the new information and all calculations. Upon receipt of such notice, any Participating Manufacturer or Settling State may dispute the Independent Auditor's calculations in the manner described in subsection (d)(3), and the Independent Auditor shall promptly notify each Notice Party of any subsequent revisions to its calculations. Not more than 15 days after receipt of such notice (or, if the Independent Auditor revises its calculations, not more than 15 days after receipt of the revisions), any Participating Manufacturer and any Settling State may dispute the Independent Auditor's calculations in the manner prescribed in subsection (d)(6). Failure to dispute the Independent Auditor's calculations in this manner shall constitute agreement with the Independent Auditor's calculations, subject to the limitations set forth in subsection (d)(6). Payment of the undisputed portion of an additional payment shall be made to the Escrow Agent not more than 20 days after receipt of the notice described in this subsection (A) (or, if the Independent Auditor revises its calculations, not more than 20 days after receipt of the revisions). Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h). Payment of the disputed portion shall be governed by subsection (d)(8).

(B) To the extent a dispute as to a prior payment is resolved with finality against a Participating Manufacturer: (i) in the case where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to the applicable payee Account(s); (ii) in the case where the disputed amount has not been paid into the Disputed Payments Account and the dispute was identified prior to the Payment Due Date in question by delivery of a statement pursuant to subsection (d)(6) identifying such dispute, the Independent Auditor shall calculate interest on the disputed amount from the Payment Due Date in question (the applicable interest rate to be that provided in subsection IX(h)) and the allocation of such amount and interest among the applicable payees, and shall provide notice of the amount owed (and the identity of the payor and payees) to all Notice Parties; and (iii) in all other cases, the procedure described in subsection (ii) shall apply, except that the applicable interest rate shall be the Prime Rate.

(2) Overpayments.

(A) If a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to such Participating Manufacturer.

(B) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date showing that a Participating Manufacturer made an overpayment on such date, or if a dispute as to a prior

payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid but not into the Disputed Payments Account, such Participating Manufacturer shall be entitled to a continuing dollar-for-dollar offset as follows:

(i) offsets under this subsection (B) shall be applied only against eligible payments to be made by such Participating Manufacturer after the entitlement to the offset arises. The eligible payments shall be: in the case of offsets arising from payments under subsection IX(b) or IX(c)(1), subsequent payments under any of such subsections; in the case of offsets arising from payments under subsection IX(c)(2), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under subsection IX(c)(1); in the case of offsets arising from payments under subsection IX(e), subsequent payments under such subsection or subsection IX(c); in the case of offsets arising from payments under subsection VI(c), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under any of subsection IX(c)(1), IX(c)(2) or IX(e); in the case of offsets arising from payments under subsection VIII(b), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under either subsection IX(c)(1) or IX(c)(2); in the case of offsets arising from payments under subsection VIII(c), subsequent payments under either subsection IX(c)(1) or IX(c)(2); and, in the case of offsets arising from payments under subsection IX(i), subsequent payments under such subsection (consistent with the provisions of this subsection (B)(i)).

(ii) in the case of offsets to be applied against payments under subsection IX(c), the offset to be applied shall be apportioned among the Settling States pro rata in proportion to their respective shares of such payments, as such respective shares are determined pursuant to step E of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or clause "Sixth" (in the case of payments due from the Subsequent Participating Manufacturers) of subsection IX(j) (except where the offset arises from an overpayment applicable solely to a particular Settling State).

(iii) the total amount of the offset to which a Participating Manufacturer shall be entitled shall be the full amount of the overpayment it made, together with interest calculated from the time of the overpayment to the Payment Due Date of the first eligible payment against which the offset may be applied. The applicable interest rate shall be the Prime Rate (except that, where the overpayment is the result of a Settling State's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h)).

(iv) an offset under this subsection (B) shall be applied up to the full amount of the Participating Manufacturer's share (in the case of payments due from Original Participating Manufacturers, determined as described in the first sentence of clause "Seventh" of subsection IX(j) (or, in the case of payments pursuant to subsection IX(c), step D of such clause)) of the eligible payment in question, as such payment has been adjusted and reduced pursuant to clauses "First" through "Sixth" of subsection IX(j), to the extent each such clause is applicable to the payment in question. In the event that the offset to which a Participating Manufacturer is entitled under this subsection (B) would exceed such Participating Manufacturer's share of the eligible payment against which it is being applied (or, in the case where such offset arises from an overpayment applicable solely to a particular Settling State, the portion of such payment that is made for the benefit of such Settling State), the offset shall be the full amount of such Participating Manufacturer's share of such payment and all amounts not offset shall carry forward and be offset against subsequent eligible payments until all such amounts have been offset.

(j) Payments After Applicable Condition. To the extent that a payment is made after the occurrence of all applicable conditions for the disbursement of such payment to the payee(s) in question, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit.

XII. SETTLING STATES' RELEASE, DISCHARGE AND COVENANT

(a) Release.

(1) Upon the occurrence of State-Specific Finality in a Settling State, such Settling State shall absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Releasing Parties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall or may have.

(2) Notwithstanding the foregoing, this release and discharge shall not apply to any defendant in a lawsuit settled pursuant to this Agreement (other than a Participating Manufacturer) unless and until such defendant releases the Releasing Parties (and delivers to the Attorney General of the applicable Settling State a copy of such release) from any and all Claims of such defendant relating to the prosecution of such lawsuit.

(3) Each Settling State (for itself and for the Releasing Parties) further covenants and agrees that it (and the Releasing Parties) shall not after the occurrence of State-Specific Finality sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

(4) (A) Each Settling State (for itself and for the Releasing Parties) further agrees that, if a Released Claim by a Releasing Party against any person or entity that is not a Released Party (a "non-Released Party") results in or in any way gives rise to a claim-over (on any theory whatever other than a claim based on an express written indemnity agreement) by such non-Released Party against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such non-Released Party the full amount of any judgment or settlement such non-Released Party may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such non-Released Party, obtain from such non-Released Party for the benefit of such Released Party a satisfaction in full of such non-Released Party's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (4)(A) do not fully eliminate any and all liability of any Original Participating Manufacturer (or of any person or entity that is a Released Party by virtue of its relation to any Original Participating Manufacturer) with respect to claims-over (on any theory whatever other than a claim based on an express written indemnity agreement) by any non-Released Party to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such non-Released Party to any Releasing Party arising out of any Released Claim, such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (4) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset and the Litigating Releasing Parties Offset): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of subsection (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of section IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(5) This release and covenant shall not operate to interfere with a Settling State's ability to enforce as against any Participating Manufacturer the provisions of this Agreement, or with the Court's ability to enter the Consent Decree or to maintain continuing jurisdiction to enforce such Consent Decree pursuant to the terms thereof. Provided, however, that neither subsection III(a) or III(r) of this Agreement nor subsection V(A) or V(I) of the Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

(6) The Settling States do not purport to waive or release any claims on behalf of Indian tribes.

(7) The Settling States do not waive or release any criminal liability based on federal, state or local law.

(8) Notwithstanding the foregoing (and the definition of Released Parties), this release and covenant shall not apply to retailers, suppliers or distributors to the extent of any liability arising from the sale or distribution of Tobacco Products of, or the supply of component parts of Tobacco Products to, any non-Released Party.

(A) Each Settling State (for itself and for the Releasing Parties) agrees that, if a claim by a Releasing Party against a retailer, supplier or distributor that would be a Released Claim but for the operation of the preceding

sentence results in or in any way gives rise to a claim-over (on any theory whatever) by such retailer, supplier or distributor against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such retailer, supplier or distributor the full amount of any judgment or settlement such retailer, supplier or distributor may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such retailer, supplier or distributor, obtain from such retailer, supplier or distributor for the benefit of such Released Party a satisfaction in full of such retailer's, supplier's or distributor's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (8)(A) above do not fully eliminate any and all liability of any Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship to an Original Participating Manufacturer) with respect to claims-over (on any theory whatever) by any such retailer, supplier or distributor to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such retailer, supplier or distributor to any Releasing Party arising out of any claim that would be a Released Claim but for the operation of the first sentence of this subsection (8), such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (8) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offset for claims-over under subsection XII(a)(4)(B)): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(9) Notwithstanding any provision of law, statutory or otherwise, which provides that a general release does not extend to claims which the creditor does not know or suspect to exist in its favor at the time of executing the release, which if known by it must have materially affected its settlement with the debtor, the releases set forth in this section XII release all Released Claims against the Released Parties, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, that the Releasing Parties may have against the Released Parties, and the Releasing Parties understand and acknowledge the significance and consequences of waiver of any such provision and hereby assume full responsibility for any injuries, damages or losses that the Releasing Parties may incur.

(b) Released Claims Against Released Parties. If a Releasing Party (or any person or entity enumerated in subsection II(pp), without regard to the power of the Attorney General to release claims of such person or entity) nonetheless attempts to maintain a Released Claim against a Released Party, such Released Party shall give written notice of such potential claim to the Attorney General of the applicable Settling State within 30 days of receiving notice of such potential claim (or within 30 days after the MSA Execution Date, whichever is later) (unless such potential claim is being maintained by such Settling State). The Released Party may offer the release and covenant as a complete defense. If it is determined at any point in such action that the release of such claim is unenforceable or invalid for any reason (including, but not limited to, lack of authority to release such claim), the following provisions shall apply:

(1) The Released Party shall take all ordinary and reasonable measures to defend the action fully. The Released Party may settle or enter into a stipulated judgment with respect to the action at any time in its sole discretion, but in such event the offset described in subsection (b)(2) or (b)(3) below shall apply only if the Released Party obtains the relevant Attorney General's consent to such settlement or stipulated judgment, which consent shall not be unreasonably withheld. The

Released Party shall not be entitled to the offset described in subsection (b)(2) or (b)(3) below if such Released Party failed to take ordinary and reasonable measures to defend the action fully.

(2) The following provisions shall apply where the Released Party is an Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with an Original Participating Manufacturer):

(A) In the event of a settlement or stipulated judgment, the settlement or stipulated amount shall give rise to a continuing offset as such amount is actually paid against the full amount of such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment until such time as the settlement or stipulated amount is fully credited on a dollar-for-dollar basis.

(B) Judgments (other than a default judgment) against a Released Party in such an action shall, upon payment of such judgment, give rise to an immediate and continuing offset against the full amount of such Original Participating Manufacturer's share (determined as described in subsection (A)) of the applicable Settling State's Allocated Payment, until such time as the judgment is fully credited on a dollar-for-dollar basis.

(C) Each Settling State reserves the right to intervene in such an action (unless such action was brought by the Settling State) to the extent authorized by applicable law in order to protect the Settling State's interest under this Agreement. Each Participating Manufacturer agrees not to oppose any such intervention.

(D) In the event that the offset under this subsection (b)(2) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the Federal Tobacco Legislation Offset and the offset for miscalculated or disputed payments): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection (2) in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(3) The following provisions shall apply where the Released Party is a Subsequent Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with a Subsequent Participating Manufacturer): Subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset as described in subsections (2)(A)-(C) above against payments it otherwise would owe under section IX(i) to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on a settlement, stipulated judgment or judgment that would give rise to an offset under such subsections if paid by an Original Participating Manufacturer.

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

(a) Within 10 days after the MSA Execution Date (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit), each Settling State and each Participating Manufacturer that is a party in any of the lawsuits identified in Exhibit D shall jointly move for a stay of all proceedings in such Settling State's lawsuit with respect to the Participating Manufacturers and all other Released Parties (except any proceeding seeking public disclosure of documents pursuant to subsection IV(b)). Such stay of a Settling State's lawsuit shall be dissolved upon the earlier of the occurrence of State-Specific Finality or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Not later than December 11, 1998 (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit):

(1) each Settling State that is a party to a lawsuit identified in Exhibit D and each Participating Manufacturer will:

(A) tender this Agreement to the Court in such Settling State for its approval; and

(B) tender to the Court in such Settling State for entry a consent decree conforming to the model consent decree attached hereto as Exhibit L (revisions or changes to such model consent decree shall be limited to the extent required by state procedural requirements to reflect accurately the factual setting of the case in question, but shall not include any substantive revision to the duties or obligations of any Settling State or Participating Manufacturer, except by agreement of all Original Participating Manufacturers); and

(2) each Settling State shall seek entry of an order of dismissal of claims dismissing with prejudice all claims against the Participating Manufacturers and any other Released Party in such Settling State's action identified in Exhibit D. Provided, however, that the Settling State is not required to seek entry of such an order in such Settling State's action against such a Released Party (other than a Participating Manufacturer) unless and until such Released Party has released the Releasing Parties (and delivered to the Attorney General of such Settling State a copy of such release) (which release shall be effective upon the occurrence of State-Specific Finality in such Settling State, and shall recite that in the event this Agreement is terminated with respect to such Settling State pursuant to subsection XVIII(u)(1) the Released Party agrees that the order of dismissal shall be null and void and of no effect) from any and all Claims of such Released Party relating to the prosecution of such action as provided in subsection XII(a)(2).

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

(a) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will dismiss without prejudice (and without costs and fees) the lawsuit(s) listed in Exhibit M pending in such Settling State in which the Participating Manufacturer is a plaintiff. Within 10 days after the MSA Execution Date, each Participating Manufacturer and each Settling State that is a party in any of the lawsuits listed in Exhibit M shall jointly move for a stay of all proceedings in such lawsuit. Such stay of a lawsuit against a Settling State shall be dissolved upon the earlier of the occurrence of State Specific Finality in such Settling State or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against such Settling State and any of such Settling State's officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel relating to or in connection with the lawsuit(s) commenced by the Attorney General of such Settling State identified in Exhibit D.

(c) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against all subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts) of such Settling State, and any of their officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel arising out of Claims that have been waived and released with continuing full force and effect pursuant to section XII of this Agreement.

XV. VOLUNTARY ACT OF THE PARTIES

The Settling States and the Participating Manufacturers acknowledge and agree that this Agreement is voluntarily entered into by each Settling State and each Participating Manufacturer as the result of arm's-length negotiations, and each Settling State and each Participating Manufacturer was represented by counsel in deciding to enter into this Agreement. Each Participating Manufacturer further acknowledges that it understands that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges and that, by voluntarily consenting to this Agreement, it (and the Tobacco-Related Organizations (or any trade associations formed or controlled by any Participating Manufacturer)) waives for purposes of performance of this Agreement any and all claims that the provisions of this Agreement violate the state or federal constitutions. Provided, however, that nothing in the foregoing shall constitute a waiver as to the entry of any court order (or any interpretation thereof) that would operate to limit the exercise of any constitutional right except to the extent of the restrictions, limitations or obligations expressly agreed to in this Agreement or the Consent Decree.

XVI. CONSTRUCTION

(a) No Settling State or Participating Manufacturer shall be considered the drafter of this Agreement or any Consent Decree, or any provision of either, for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter.

(b) Nothing in this Agreement shall be construed as approval by the Settling States of any Participating Manufacturer's business organizations, operations, acts or practices, and no Participating Manufacturer may make any representation to the contrary.

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

(a) The Original Participating Manufacturers agree that, with respect to any Settling State in which the Court has approved this Agreement and the Consent Decree, they shall severally reimburse the following "Governmental Entities": (1) the office of the Attorney General of such Settling State; (2) the office of the governmental prosecuting authority for any political

subdivision of such Settling State with a lawsuit pending against any Participating Manufacturer as of July 1, 1998 (as identified in Exhibit N) that has released such Settling State and such Participating Manufacturer(s) from any and all Released Claims (a "Litigating Political Subdivision"); and (3) other appropriate agencies of such Settling State and such Litigating Political Subdivision, for reasonable costs and expenses incurred in connection with the litigation or resolution of claims asserted by or against the Participating Manufacturers in the actions set forth in Exhibits D, M and N; provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers would reimburse their own counsel or agents (but not including costs and expenses relating to lobbying activities).

(b) The Original Participating Manufacturers further agree severally to pay the Governmental Entities in any Settling State in which State-Specific Finality has occurred an amount sufficient to compensate such Governmental Entities for time reasonably expended by attorneys and paralegals employed in such offices in connection with the litigation or resolution of claims asserted against or by the Participating Manufacturers in the actions identified in Exhibits D, M and N (but not including time relating to lobbying activities), such amount to be calculated based upon hourly rates equal to the market rate in such Settling State for private attorneys and paralegals of equivalent experience and seniority.

(c) Such Governmental Entities seeking payment pursuant to subsection (a) and/or (b) shall provide the Original Participating Manufacturers with an appropriately documented statement of all costs, expenses and attorney and paralegal time for which payment is sought, and, solely with respect to payments sought pursuant to subsection (b), shall do so no earlier than the date on which State-Specific Finality occurs in such Settling State. All amounts to be paid pursuant to subsections (a) and (b) shall be subject to reasonable verification if requested by any Original Participating Manufacturer; provided, however, that nothing contained in this subsection (c) shall constitute, cause, or require the performance of any act that would constitute any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint prosecution privilege. All such amounts to be paid pursuant to subsections (a) and (b) shall be subject to an aggregate cap of $150 million for all Settling States, shall be paid promptly following submission of the appropriate documentation (and the completion of any verification process), shall be paid separately and apart from any other amounts due pursuant to this Agreement, and shall be paid severally by each Original Participating Manufacturer according to its Relative Market Share. All amounts to be paid pursuant to subsection (b) shall be paid to such Governmental Entities in the order in which State-Specific Finality has occurred in such Settling States (subject to the $150 million aggregate cap).

(d) The Original Participating Manufacturers agree that, upon the occurrence of State-Specific Finality in a Settling State, they will severally pay reasonable attorneys' fees to the private outside counsel, if any, retained by such Settling State (and each Litigating Political Subdivision, if any, within such Settling State) in connection with the respective actions identified in Exhibits D, M and N and who are designated in Exhibit S for each Settling State by the relevant Attorney General (and for each Litigating Political Subdivision, as later certified in writing to the Original Participating Manufacturers by the relevant governmental prosecuting authority of each Litigating Political Subdivision) as having been retained by and having represented such Settling State (or such Litigating Political Subdivision), in accordance with the terms described in the Model Fee Payment Agreement attached as Exhibit O.

XVIII. MISCELLANEOUS

(a) Effect of Current or Future Law. If any current or future law includes obligations or prohibitions applying to Tobacco Product Manufacturers related to any of the provisions of this Agreement, each Participating Manufacturer shall comply with this Agreement unless compliance with this Agreement would violate such law.

(b) Limited Most-Favored Nation Provision.

(1) If any Participating Manufacturer enters into any future settlement agreement of other litigation comparable to any of the actions identified in Exhibit D brought by a non-foreign governmental plaintiff other than the federal government ("Future Settlement Agreement"):

(A) before October 1, 2000, on overall terms more favorable to such governmental plaintiff than the overall terms of this Agreement (after due consideration of relevant differences in population or other appropriate factors), then, unless a majority of the Settling States determines that the overall terms of the Future Settlement Agreement are not more favorable than the overall terms of this Agreement, the overall terms of this Agreement will be revised so that the Settling States will obtain treatment with respect to such Participating Manufacturer at least as relatively favorable as the overall terms provided to any such governmental plaintiff; provided, however, that as to economic terms this Agreement shall not be revised based on any such Future Settlement Agreement if such Future Settlement Agreement is entered into after: (i) the impaneling of the jury (or, in the event of a non-jury trial, the commencement of trial) in such litigation or any severed or bifurcated portion thereof; or (ii) any court order or judicial determination relating to such litigation that (x) grants judgment (in whole or in part) against such

Participating Manufacturer; or (y) grants injunctive or other relief that affects the assets or on-going business activities of such Participating Manufacturer in a manner other than as expressly provided for in this Agreement; or

(B) on or after October 1, 2000, on non-economic terms more favorable to such governmental plaintiff than the non-economic terms of this Agreement, and such Future Settlement Agreement includes terms that provide for the implementation of non-economic tobacco-related public health measures different from those contained in this Agreement, then this Agreement shall be revised with respect to such Participating Manufacturer to include terms comparable to such non-economic terms, unless a majority of the Settling States elects against such revision.

(2) If any Settling State resolves by settlement Claims against any Non-Participating Manufacturer after the MSA Execution Date comparable to any Released Claim, and such resolution includes overall terms that are more favorable to such Non-Participating Manufacturer than the terms of this Agreement (including, without limitation, any terms that relate to the marketing or distribution of Tobacco Products and any term that provides for a lower settlement cost on a per pack sold basis), then the overall terms of this Agreement will be revised so that the Original Participating Manufacturers will obtain, with respect to that Settling State, overall terms at least as relatively favorable (taking into account, among other things, all payments previously made by the Original Participating Manufacturers and the timing of any payments) as those obtained by such Non-Participating Manufacturer pursuant to such resolution of Claims. The foregoing shall include but not be limited: (a) to the treatment by any Settling State of a Future Affiliate, as that term is defined in agreements between any of the Settling States and Brooke Group Ltd., Liggett & Myers Inc. and/or Liggett Group, Inc. ("Liggett"), whether or not such Future Affiliate is merged with, or its operations combined with, Liggett or any Affiliate thereof; and (b) to any application of the terms of any such agreement (including any terms subsequently negotiated pursuant to any such agreement) to a brand of Cigarettes (or tobacco-related assets) as a result of the purchase by or sale to Liggett of such brand or assets or as a result of any combination of ownership among Liggett and any entity that manufactures Tobacco Products. Provided, however, that revision of this Agreement pursuant to this subsection (2) shall not be required by virtue of the subsequent entry into this Agreement by a Tobacco Product Manufacturer that has not become a Participating Manufacturer as of the MSA Execution Date. Notwithstanding the provisions of subsection XVIII(j), the provisions of this subsection XVIII(b)(2) may be waived by (and only by) unanimous agreement of the Original Participating Manufacturers.

(3) The parties agree that if any term of this Agreement is revised pursuant to subsection (b)(1) or (b)(2) above and the substance of such term before it was revised was also a term of the Consent Decree, each affected Settling State and each affected Participating Manufacturer shall jointly move the Court to amend the Consent Decree to conform the terms of the Consent Decree to the revised terms of the Agreement.

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

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

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

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

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

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

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

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

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

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

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

will support the integrity and enforcement of the terms of this Agreement and the Consent Decrees. Each Settling State shall use its best efforts to cause State-Specific Finality to occur as to such Settling State.

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

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

(o) Severability.

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

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

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

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

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

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

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

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

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

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

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

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

(u) Termination.

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

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

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

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

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

(A) all agreements, all concessions, all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall be null and void as to such Participating Manufacturer. Provided, however, that (i) all reductions of Releasing Parties' Claims, and all releases and covenants not to sue, contained in this Agreement shall remain in full force and effect as to all persons or entities (other than the bankrupt Participating Manufacturer itself or any person or entity that, as a result of the Bankruptcy, obtains domestic tobacco assets of such Participating Manufacturer (unless such person or entity is itself a Participating Manufacturer)) who (but for the first sentence of this subsection (A)) would otherwise be Released Parties by virtue of their relationship with the bankrupt Participating Manufacturer; and (ii) in the event a Settling State asserts any Released Claim against a bankrupt Participating Manufacturer after the termination of this Agreement with respect to such Participating Manufacturer as described in this subsection (1) and receives a judgment, settlement or distribution arising from such Released Claim, then the amount of any payments such Settling State has previously received from such Participating Manufacturer under this Agreement shall be applied against the amount of any such

judgment, settlement or distribution (provided that in no event shall such Settling State be required to refund any payments previously received from such Participating Manufacturer pursuant to this Agreement);

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

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

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

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

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

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

businesses of any Participating Manufacturer (provided that such Participating Manufacturer shall continue to be treated as a Subsequent Participating Manufacturer and Participating Manufacturer for all other purposes under such subsection).

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

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

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

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

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

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

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

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

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

EXHIBIT A
STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373 %
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833 %
Nevada	0.6099351 %
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851 %
Virginia	2.0447451%
Washington	2.0532582%

West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371 %
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

EXHIBIT B
FORM OF ESCROW AGREEMENT

This Escrow Agreement is entered into as of _____, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and _____ as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the Settling States and the Participating Manufacturers have entered into a settlement agreement entitled the "Master Settlement Agreement" (the "Agreement"); and

WHEREAS, the Agreement requires the Settling States and the Participating Manufacturers to enter into this Escrow Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

The Settling States and the Participating Manufacturers hereby appoint _____ to serve as Escrow Agent under this Agreement on the terms and conditions set forth herein, and the Escrow Agent, by its execution hereof, hereby accepts such appointment and agrees to perform the duties and obligations of the Escrow Agent set forth herein. The Settling States and the Participating Manufacturers agree that the Escrow Agent appointed under the terms of this Escrow Agreement shall be the Escrow Agent as defined in, and for all purposes of, the Agreement.

SECTION 2. *Definitions.*

(a) Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the Agreement.

(b) "Escrow Court" means the court of the State of New York to which the Agreement is presented for approval, or such other court as agreed to by the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question.

SECTION 3. *Escrow and Accounts.*

(a) All funds received by the Escrow Agent pursuant to the terms of the Agreement shall be held and disbursed in accordance with the terms of this Escrow Agreement. Such funds and any earnings thereon shall constitute the "Escrow" and shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the Settling States and the Participating Manufacturers.

(b) The Escrow Agent shall allocate the Escrow among the following separate accounts (each an "Account" and collectively the "Accounts"):

SUBSECTION VI(B) ACCOUNT
SUBSECTION VI(C) ACCOUNT (FIRST)
SUBSECTION VI(C) ACCOUNT (SUBSEQUENT)
SUBSECTION VIII(B) ACCOUNT
SUBSECTION VIII(C) ACCOUNT
SUBSECTION IX(B) ACCOUNT (FIRST)
SUBSECTION IX(B) ACCOUNT (SUBSEQUENT)
SUBSECTION IX(C)(1) ACCOUNT
SUBSECTION IX(C)(2) ACCOUNT
SUBSECTION IX(E) ACCOUNT
DISPUTED PAYMENTS ACCOUNT
STATE-SPECIFIC ACCOUNTS WITH RESPECT TO EACH SETTLING STATE IN WHICH STATE-SPECIFIC FINALITY OCCURS.

(c) All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement pursuant to (i) written instructions from the Independent Auditor; or (ii) written instructions from all of the following: all of the Original Participating Manufacturers; all of the Subsequent Participating Manufacturers that contributed to such amounts in such Account; and all of the Settling States (collectively, the "Escrow Parties"). In the event of a conflict, instructions pursuant to clause (ii) shall govern over instructions pursuant to clause (i).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

The Escrow Agent shall invest and reinvest all amounts from time to time credited to the Accounts in either (i) direct obligations of, or obligations the principal and interest on which are unconditionally guaranteed by, the United States of America; (ii) repurchase agreements fully collateralized by securities described in clause (i) above; (iii) money market accounts maturing within 30 days of the acquisition thereof and issued by a bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof (a "United States Bank") and having combined capital, surplus and undistributed profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undistributed profits in excess of $500,000,000. To the extent practicable, monies credited to any Account shall be invested in such a manner so as to be available for use at the times when monies are expected to be disbursed by the Escrow Agent and charged to such Account. Obligations purchased as an investment of monies credited to any Account shall be deemed at all times to be a part of such Account and the income or interest earned, profits realized or losses suffered with respect to such investments (including, without limitation, any penalty for any liquidation of an investment required to fund a disbursement to be charged to such Account), shall be credited or charged, as the case may be, to, such Account and shall be for the benefit of, or be borne by, the person or entity entitled to payment from such Account. In choosing among the investment options described in clauses (i) through (iv) above, the Escrow Agent shall comply with any instructions received from time to time from all of the Escrow Parties. In the absence of such instructions, the Escrow Agent shall invest such sums in accordance with clause (i) above. With respect to any amounts credited to a State-Specific Account, the Escrow Agent shall invest and reinvest all amounts credited to such Account in accordance with the law of the applicable Settling State to the extent such law is inconsistent with this Section 5.

SECTION 6. *Substitute Form W-9; Qualified Settlement Fund.*

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-1. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. *Duties and Liabilities of Escrow Agent.*

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The

Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. *Indemnification of Escrow Agent.*

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. *Resignation of Escrow Agent.*

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. *Escrow Agent Fees and Expenses.*

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. *Notices.*

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. *Setoff; Reimbursement.*

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. *Intended Beneficiaries; Successors.*

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. *Governing Law.*

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. *Jurisdiction and Venue.*

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. *Amendments.*

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. *Counterparts.*

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement must promptly thereafter be delivered to each party.

SECTION 18. *Captions*.

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. *Conditions to Effectiveness*.

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments.*

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting.*

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A
Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING
INFLATION ADJUSTMENTS

(1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.

(2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.

(3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.

(4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).

(5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).

(6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.

(7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):

-- the subsection IX(c)(1) base payment amount for 2002 of $6,500,000,000 as adjusted for inflation would equal $7,137,204,750;

-- the subsection IX(c)(1) base payment amount for 2004 of $8,000,000,000 as adjusted for inflation would equal $9,455,368,856;

-- the subsection IX(c)(1) base payment amount for 2006 of $8,000,000,000 as adjusted for inflation would equal $10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
Blaylock et al. v. American Tobacco Co. et al., Circuit Court, Montgomery County, No. CV-96-1508-PR
2. Alaska
State of Alaska v. Philip Morris, Inc., et al., Superior Court, First Judicial District of Juneau, No. IJU-97915 CI (Alaska)
3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)
4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)
5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301
6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)
7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV 96-0148414S (Conn.)
8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)
9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)
10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)
11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)
12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)
13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)
14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)
15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)
16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)
17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)
18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)
19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)
20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)
21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)
22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)
23. Nevada
Nevada v. Philip Morris. Incorporate, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)
25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (ICJ.)
26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)
27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)
28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)
29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)
30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)
31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443
32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF
33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)
34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)
35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)
36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)
37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)
38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-1505608SEA (Wash.)
39. West Virginia
McGraw, et al. v. The American Tobacco Company, et al., Kanawha County Circuit Court, No. 94-1707 (W. Va.)
40. Wisconsin
State of Wisconsin v. Philip Morris Inc., et al., Circuit Court, Branch 11, Dane County, No. 97-CV-328 (Wis.)

Additional States
For each Settling State not listed above, the lawsuit or other legal action filed by the Attorney General or Governor of such Settling State against Participating Manufacturers in the Court in such Settling State prior to 30 days after the MSA Execution Date asserting Released Claims.

EXHIBIT E
FORMULA FOR CALCULATING
VOLUME ADJUSTMENTS

Any amount that by the terms of the Master Settlement Agreement is to be adjusted pursuant to this Exhibit E (the "Applicable Base Payment") shall be adjusted in the following manner:

(A) In the event the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by the Original Participating Manufacturers in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than 475,656,000,000 Cigarettes (the "Base Volume"), the Applicable Base Payment shall be multiplied by the ratio of the Actual Volume to the Base Volume.

(B) In the event the Actual Volume is less than the Base Volume,

i. The Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 0.98 and by the result of (i) 1(one) minus (ii) the ratio of the Actual Volume to the Base Volume.

ii. Solely for purposes of calculating volume adjustments to the payments required under subsection IX(c)(1), if a reduction of the Base Payment due under such subsection results from the application of subparagraph (B)(i) of this Exhibit E, but the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes for the Applicable Year in the fifty United States, the District of Columbia, and Puerto Rico (the "Actual Operating Income") is greater than $7,195,340,000 (the "Base Operating Income") (such Base Operating Income being adjusted upward in accordance with the formula for inflation adjustments set forth in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996) then the amount by which such Base Payment is reduced by the application of subsection (B)(i) shall be reduced (but not below zero) by the amount calculated by multiplying (i) a percentage equal to the aggregate Allocable Shares of the Settling States in which State-Specific Finality has occurred by (ii) 25% of such increase in such operating income. For purposes of this Exhibit E, "operating income from sales of Cigarettes" shall mean operating income from sales of Cigarettes in the fifty United States, the District of Columbia, and Puerto Rico: (a) before goodwill amortization, trademark amortization, restructuring charges and restructuring related charges, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes; and (b) excluding extraordinary items, cumulative effect of changes in method of accounting and discontinued operations -- all as such income is reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of such Participating Manufacturer) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with U.S. generally accepted accounting principles and audited by a nationally recognized accounting firm. For years subsequent to 1998, the determination of the Original Participating Manufacturers' aggregate operating income from sales of Cigarettes shall not exclude any charges or expenses incurred or accrued in connection with this Agreement or any prior settlement of a tobacco and health case and shall otherwise be derived using the same principles as were employed in deriving such Original Participating Manufacturers' aggregate operating income from sales of Cigarettes in 1996.

iii. Any increase in a Base Payment pursuant to subsection (B)(ii) above shall be allocated among the Original Participating Manufacturers in the following manner:

(1) only to those Original Participating Manufacturers whose operating income from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico for the year for which the Base Payment is being adjusted is greater than their respective operating income from such sales of Cigarettes (including operating income from such sales of any of their Affiliates that do not continue to have such sales after the MSA Execution Date) in 1996 (as increased for inflation as provided in Exhibit C hereto beginning December 31, 1996 to be applied for each year after 1996); and

(2) among the Original Participating Manufacturers described in paragraph (1) above in proportion to the ratio of (x) the increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of the Original Participating Manufacturer in question, to (y) the aggregate increase in the operating income from sales of Cigarettes (as described in paragraph (1)) of those Original Participating Manufacturers described in paragraph (1) above.

(C) "Applicable Year" means the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) For purposes of this Exhibit, shipments shall be measured as provided in subsection II(mm).

EXHIBIT F
POTENTIAL LEGISLATION NOT TO BE OPPOSED

1. Limitations on Youth access to vending machines.
2. Inclusion of cigars within the definition of tobacco products.
3. Enhancement of enforcement efforts to identify and prosecute violations of laws prohibiting retail sales to Youth.
4. Encouraging or supporting use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners, scanners to read drivers' licenses, or use of other age/ID data banks.
5. Limitations on promotional programs for non-tobacco goods using tobacco products as prizes or give-aways.
6. Enforcement of access restrictions through penalties on Youth for possession or use.
7. Limitations on tobacco product advertising in or on school facilities, or wearing of tobacco logo merchandise in or on school property.
8. Limitations on non-tobacco products which are designed to look like tobacco products, such as bubble gum cigars, candy cigarettes, etc.

EXHIBIT G
OBLIGATIONS OF THE TOBACCO INSTITUTE
UNDER THE MASTER SETTLEMENT AGREEMENT

(a) Upon court approval of a plan of dissolution The Tobacco Institute ("TI") will:

(1) Employees. Promptly notify and arrange for the termination of the employment of all employees; provided, however, that TI may continue to engage any employee who is (A) essential to the wind-down function as set forth in section (g) herein; (B) reasonably needed for the sole purpose of directing and supporting TI's defense of ongoing litigation; or (C) reasonably needed for the sole purpose of performing the Tobacco Institute Testing Laboratory's (the "TITL") industry-wide cigarette testing pursuant to the Federal Trade Commission (the "FTC") method or any other testing prescribed by state or federal law as set forth in section (h) herein.

(2) Employee Benefits. Fund all employee benefit and pension programs; provided, however, that unless ERISA or other federal or state law prohibits it, such funding will be accomplished through periodic contributions by the Original Participating Manufacturers, according to their Relative Market Shares, into a trust or a like mechanism, which trust or like mechanism will be established within 90 days of court approval of the plan of dissolution. An opinion letter will be appended to the dissolution plan to certify that the trust plan is not inconsistent with ERISA or employee benefit pension contracts.

(3) Leases. Terminate all leaseholds at the earliest possible date pursuant to the leases; provided, however, that TI may retain or lease anew such space (or lease other space) as needed for its wind-down activities, for TITL testing as described herein, and for subsequent litigation defense activities. Immediately upon execution of this Agreement, TI will provide notice to each of its landlords of its desire to terminate its lease with such landlord, and will request that the landlord take all steps to re-lease the premises at the earliest possible date consistent with TI's performance of its obligations hereunder. TI will vacate such leasehold premises as soon as they are re-leased or on the last day of wind-down, whichever occurs first.

(b) Assets/Debts. Within 60 days after court approval of a plan of dissolution, TI will provide to the Attorney General of New York and append to the dissolution plan a description of all of its assets, its debts, tax claims against it, claims of state and federal governments against it, creditor claims against it, pending litigation in which it is a party and notices of claims against it.

(c) Documents. Subject to the privacy protections provided by New York Public Officers Law §§ 91-99, TI will provide a copy of or otherwise make available to the State of New York all documents in its possession, excluding those that TI continues to claim to be subject to any attorney-client privilege, attorney work product protection, common interest/joint defense privilege or any other applicable privilege (collectively, "privilege") after the re-examination of privilege claims pursuant to court order in State of Oklahoma v. R.J. Reynolds Tobacco Company, et al., CJ-96-2499-L (Dist. Ct., Cleveland County) (the "Oklahoma action"):

(1) TI will deliver to the Attorney General of the State of New York a copy of the privilege log served by it in the Oklahoma action. Upon a written request by the Attorney General, TI will deliver an updated version of its privilege log, if any such updated version exists.

(2) The disclosure of any document or documents claimed to be privileged will be governed by section IV of this Agreement.

(3) At the conclusion of the document production and privilege logging process, TI will provide a sworn affidavit that all documents in its possession have been made available to the Attorney General of New York except for documents claimed to be privileged, and that any privilege logs that already exist have been made available to the Attorney General.

(d) Remaining Assets. On mutual agreement between TI and the Attorney General of New York, a not-for-profit health or child welfare organization will be named as the beneficiary of any TI assets that remain after lawful transfers of assets and satisfaction of TI's employee benefit obligations and any other debts, liabilities or claims.

(e) Defense of Litigation. Pursuant to Section 1006 of the New York Not-for-Profit Corporations Law, TI will have the right to continue to defend its litigation interests with respect to any claims against it that are pending or threatened now or that are brought or threatened in the future. TI will retain sole discretion over all litigation decisions, including, without limitation, decisions with respect to asserting any privileges or defenses, having privileged communications and creating privileged documents, filing pleadings, responding to discovery requests, making motions, filing affidavits and briefs, conducting

party and non-party discovery, retaining expert witnesses and consultants, preparing for and defending itself at trial, settling any claims asserted against it, intervening or otherwise participating in litigation to protect interests that it deems significant to its defense, and otherwise directing or conducting its defense. Pursuant to existing joint defense agreements, TI may continue to assist its current or former members in defense of any litigation brought or threatened against them. TI also may enter into any new joint defense agreement or agreements that it deems significant to its defense of pending or threatened claims. TI may continue to engage such employees as reasonably needed for the sole purpose of directing and supporting its defense of ongoing litigation. As soon as TI has no litigation pending against it, it will dissolve completely and will cease all functions consistent with the requirements of law.

(f) No public statement. Except as necessary in the course of litigation defense as set forth in section (e) above, upon court approval of a plan of dissolution, neither TI nor any of its employees or agents acting in their official capacity on behalf of TI will issue any statements, press releases, or other public statement concerning tobacco.

(g) Wind-down. After court approval of a plan of dissolution, TI will effectuate wind-down of all activities (other than its defense of litigation as described in section (e) above) expeditiously, and in no event later than 180 days after the date of court approval of the plan of dissolution. TI will provide monthly status reports to the Attorney General of New York regarding the progress of wind-down efforts and work remaining to be done with respect to such efforts.

(h) TITL. Notwithstanding any other provision of this Exhibit G or the dissolution plan, TI may perform TITL industry-wide cigarette testing pursuant to the FTC method or any other testing prescribed by state or federal law until such function is transferred to another entity, which transfer will be accomplished as soon as practicable but in no event more than 180 days after court approval of the dissolution plan.

(i) Jurisdiction. After the filing of a Certificate of Dissolution, pursuant to Section 1004 of the New York Not-for-Profit Corporation Law, the Supreme Court for the State of New York will have continuing jurisdiction over the dissolution of TI and the winding-down of TI's activities, including any litigation-related activities described in subsection (e) herein.

(j) No Determination or Admission. The dissolution of TI and any proceedings taken hereunder are not intended to be and shall not in any event be construed as, deemed to be, or represented or caused to be represented by any Settling State as, an admission or concession or evidence of any liability or any wrongdoing whatsoever on the part of TI, any of its current or former members or anyone acting on their behalf. TI specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it by the Attorneys General of the Settling States.

(k) Court Approval. The Attorney General of the State of New York and the Original Participating Manufacturers will prepare a joint plan of dissolution for submission to the Supreme Court of the State of New York, all of the terms of which will be agreed on and consented to by the Attorney General and the Original Participating Manufacturers consistent with this schedule. The Original Participating Manufacturers and their employees, as officers and directors of TI, will take whatever steps are necessary to execute all documents needed to develop such a plan of dissolution and to submit it to the court for approval. If any court makes any material change to any term or provision of the plan of dissolution agreed upon and consented to by the Attorney General and the Original Participating Manufacturers, then:

(1) the Original Participating Manufacturers may, at their election, nevertheless proceed with the dissolution plan as modified by the court; or

(2) if the Original Participating Manufacturers elect not to proceed with the court-modified dissolution plan, the Original Participating Manufacturers will be released from any obligations or undertakings under this Agreement or this schedule with respect to TI; provided, however, that the Original Participating Manufacturers will engage in good faith negotiations with the New York Attorney General to agree upon the term or terms of the dissolution plan that the court may have modified in an effort to agree upon a dissolution plan that may be resubmitted for the court's consideration.

EXHIBIT H
DOCUMENT PRODUCTION

Section 1.

(a) Philip Morris Companies, Inc., et al., v. American Broadcasting Companies, Inc., et al., At Law No. 760CL94X00816-00 (Cir. Ct., City of Richmond)

(b) Harley-Davidson v. Lorillard Tobacco Co., No. 93-947 (S.D.N.Y.)

(c) Lorillard Tobacco Co. v. Harley-Davidson, No. 93-6098 (E.D. Wis.)

(d) Brown & Williamson v. Jacobson and CBS, Inc., No. 82-648 (N.D. Ill.)

(e) The FTC investigations of tobacco industry advertising and promotion as embodied in the following cites:

46 FTC 706
48 FTC 82
46 FTC 735
47 FTC 1393
108 F. Supp. 573
55 FTC 354
56 FTC 96
79 FTC 255
80 FTC 455
Investigation #8023069
Investigation #8323222

Each Original Participating Manufacturer and Tobacco-Related Organization will conduct its own reasonable inquiry to determine what documents or deposition testimony, if any, it produced or provided in the above-listed matters. Section 2.

(a) State of Washington v. American Tobacco Co., et al., No. 96-2-15056-8 SEA (Wash. Super. Ct., County of King)

(b) In re Mike Moore, Attorney General, ex rel, State of Mississippi Tobacco Litigation, No. 94-1429 (Chancery Ct., Jackson, Miss.)

(c) State of Florida v. American Tobacco Co., et al., No. CL 95-1466 AH (Fla. Cir. Ct., 15th Judicial Cir., Palm Beach Co.)

(d) State of Texas v. American Tobacco Co., et al., No. 5-96CV-91 (E.D. Tex.)

(e) Minnesota v. Philip Morris et al., No. C-94-8565 (Minn. Dist. Ct., County of Ramsey)

(f) Broin v. R.J. Reynolds, No. 91-49738 CA (22) (11th Judicial Ct., Dade County, Florida)

EXHIBIT I
INDEX AND SEARCH FEATURES FOR DOCUMENT WEBSITE

(a) Each Original Participating Manufacturer and Tobacco-Related Organization will create and maintain on its website, at its expense, an enhanced, searchable index, as described below, using Alta-Vista or functionally comparable software, for all of the documents currently on its website and all documents being placed on its website pursuant to section IV of this Agreement.

(b) The searchable indices of documents on these websites will include:

(1) all of the information contained in the 4(b) indices produced to the State Attorneys General (excluding fields specific only to the Minnesota action other than "request number");

(2) the following additional fields of information (or their substantial equivalent) to the extent such information already exists in an electronic format that can be incorporated into such an index:

Document ID	Master ID
Other Number	Document Date
Primary Type	Other Type
Person Attending	Person Noted
Person Author	Person Recipient
Person Copied	Person Mentioned
Organization Author	Organization Recipient
Organization Copied	Organization Mentioned
Organization Attending	Organization Noted
Physical Attachment 1	Physical Attachment 2
Characteristics	File Name
Site	Area
Verbatim Title	Old Brand
Primary Brand	Mentioned Brand
Page Count	

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(h) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant

Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the Special Committee shall designate the times for such meetings, so that a response is made to the Grant Application as expeditiously as practicable.

Section 9

The Special Committee may issue a grant from the Fund only when an Attorney General certifies that the monies will be used in connection with a Qualifying Action, to wit: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute. The Attorney General submitting such application shall further certify that the entire grant of monies from the Fund will be used to pay for such investigation and/or litigation. The Grant Application shall describe the nature and scope of the intended action and use of the funds which may be granted.

Section 10

To the extent permitted by law, each Attorney General whose Grant Application is favorably acted upon shall promise to pay back to the Fund all of the amounts received from the Fund in the event the state is successful in litigation or settlement of a Qualifying Action. In the event that the monetary recovery, if any, obtained is not sufficient to pay back the entire amount of the grant, the Attorney General shall pay back as much as is permitted by the recovery. In all instances where monies are granted, the Attorney General(s) receiving monies shall provide an accounting to NAAG of all disbursements received from the Fund no later than the 30th of June next following such disbursement.

Section 11

In addition to the repayments to the Fund contemplated in the preceding section, the Special Committee may deposit in the Fund any other monies lawfully committed for the precise purpose of the Fund as set forth in section A(3) above. For example, the Special Committee may at its discretion accept for deposit in the Fund a foundation grant or court-ordered award for state antitrust and/or consumer protection enforcement as long as the monies so deposited become part of and subject to the same rules, purposes and limitations of the Fund.

Section 12

The Special Committee shall be the sole and final arbiter of all Grant Applications and of the amount awarded for each such application, if any.

Section 13

The Special Committee shall endeavor to maintain the Fund for as long a term as is consistent with the purpose of the Fund. The Special Committee will limit the total amount of grants made to a single state to no more than $500,000.00. The Special Committee will not award a single grant in excess of $200,000.00, unless the grant involves more than one state, in which case, a single grant so made may not total more than $300,000.00. The Special Committee may, in its discretion and by unanimous vote, decide to waive these limitations if it determines that special circumstances exist. Such decision, however, shall not be effective unless ratified by a two-thirds majority vote of the NAAG executive committee.

Section C
Grant Application Procedures

Section 1

This Protocol shall be transmitted to the Attorneys General within 90 days after the MSA Execution Date. It may not be amended unless by recommendation of the NAAG executive committee and majority vote of the Settling States. NAAG will notify the Settling States of any amendments promptly and will transmit yearly to the attorneys general a statement of the Fund balance and a summary of deposits to and withdrawals from the Fund in the previous calendar or fiscal year.

Section 2

Grant Applications must be in writing and must be signed by the Attorney General submitting the application.

Section 3

Grant Applications must include the following:

(A) A description of the contemplated/pending action, including the scope of the alleged violation and the area (state/regional/multi-state) likely to be affected by the suspected offending conduct.

(B) A statement whether the action is actively and currently pursued by any other Attorney General or other prosecuting authority.

(C) A description of the purposes for which the monies sought will be used.

(D) The amount requested.

(E) A directive as to how disbursements from the Fund should be made, e.g., either directly to a supplier of services (consultants, experts, witnesses, and the like), to the Attorney General's office directly, or in the case of multi-state action, to one or more Attorneys General's offices designated as a recipient of the monies.

(F) A statement that the applicant Attorney(s) General will, to the extent permitted by law, pay back to the Fund all, or as much as is possible, of the monies received, upon receipt of any monetary recovery obtained in the contemplated/pending litigation or settlement of the action.

(G) A certification that no part of the grant monies will be used to pay the salaries or ordinary expenses of any regular employee of the office of the applicant(s) and that the grant will be used solely to pay for the stated purpose.

(H) A certification that an accounting will be provided to NAAG of all monies received by the applicant(s) by no later than the 30th of June next following any receipt of such monies.

Section 4

All Grant Applications shall be submitted to the NAAG office at the following address: National Association of Attorneys General, 750 1st Street, NE, Suite 1100, Washington D.C. 20002.

Section 5

The Special Committee will endeavor to act upon all complete and properly submitted Grant Applications within 30 days of receipt of said applications.

Section D
Other Disbursements from the Fund

Section 1

To enforce and implement the terms of the Agreement, the Special Committee shall direct disbursements from the Fund to comply with the partial payment obligations set forth in section XI of the Agreement relative to costs of the Independent Auditor. A report of such disbursements shall be included in the accounting given pursuant to section C(1) above.

Section E
Administrative Costs

Section 1

NAAG shall receive from the Fund on July 1, 1999 and on July 1 of each year thereafter an administrative fee of $100,000 for its administrative costs in performing its duties under the Protocol and this Agreement. The NAAG executive committee may adjust the amount of the administrative fee in extraordinary circumstances.

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.3000000%
R.J. Reynolds Tobacco Company	6.8000000%
Total	100.0000000%

EXHIBIT L
MODEL CONSENT DECREE

IN THE [XXXXXX] COURT OF THE STATE OF [XXXXXX]
IN AND FOR THE COUNTY OF [XXXXX]
_____ x CAUSE NO. XXXXXX

STATE OF [XXXXXXXXXXX],
Plaintiff,
v. CONSENT DECREE AND FINAL JUDGMENT
[XXXXXX XXXXX XXXX], et al., Defendants.

_____ x

WHEREAS, Plaintiff, the State of [name of Settling State], commenced this action on [date], [by and through its Attorney General [name]], pursuant to [her/his/its] common law powers and the provisions of [state and/or federal law];

WHEREAS, the State of [name of Settling State] asserted various claims for monetary, equitable and injunctive relief on behalf of the State of [name of Settling State] against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint [and amended complaints, if any] and denied the State's allegations [and asserted affirmative defenses];

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this [county/district].

II. DEFINITIONS

The definitions set forth in the Agreement (a copy of which is attached hereto) are incorporated herein by reference.

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of [name of Settling State] or a Released Party. The State of [name of Settling State] may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of [name of Settling State] in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of [name of Settling State].

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of [name of Settling State] any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of [name of Settling State] any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of [name of Settling State], any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of [name of Settling State] any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a

"two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VI. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of [name of Settling State] and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of [name of Settling State] and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections V(A) and V(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this

Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI and VII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of [name of Settling State] and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of [name of Settling State] and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred by the State of [name of Settling State] in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of [name of Settling State] may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for [name of Settling State] to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of [name of Settling State] of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of [name of Settling State] or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection V(A) or V(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the person[s] signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of [name of Settling State].

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____day of _____, 1998.

EXHIBIT M
LIST OF PARTICIPATING MANUFACTURERS' LAWSUITS AGAINST THE SETTLING STATES

1. Philip Morris, Inc., et al. v. Margery Bronster, Attorney General of the State of Hawaii, In Her Official Capacity, Civ. No. 96-00722HG, United States District Court for the District of Hawaii

2. Philip Morris, Inc., et al. v. Bruce Botelho, Attorney General of the State of Alaska, In His Official Capacity, Civ. No. A97-0003CV, United States District Court for the District of Alaska

3. Philip Morris, Inc., et al. v. Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, In His Official Capacity, Civ. No. 95-12574-GAO, United States District Court for the District of Massachusetts

4. Philip Morris, Inc., et al. v. Richard Blumenthal, Attorney General of the State of Connecticut, In His Official Capacity, Civ. No. 396CV01221 (PCD), United States District Court for the District of Connecticut

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-ev-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute Inc., et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96

2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. I 1997/359

3. County of Los Angeles v. R.J. Reynolds Tobacco Co. et al., San Diego Superior Court, No. 707651

4. The People v. Philip Morris, Inc. et al., San Francisco Superior Court, No. 980864

5. County of Cook v. Philip Morris, Inc. et al., Circuit Court of Cook County, Ill., No. 97-L-4550

EXHIBIT O
MODEL STATE FEE PAYMENT AGREEMENT

This STATE Fee Payment Agreement (the "STATE Fee Payment Agreement") is entered into as of _____, _____ between and among the Original Participating Manufacturers and STATE Outside Counsel (as defined herein), to provide for payment of attorneys' fees pursuant to Section XVII of the Master Settlement Agreement (the "Agreement").

WITNESSETH:

WHEREAS, the State of STATE and the Original Participating Manufacturers have entered into the Agreement to settle and resolve with finality all Released Claims against the Released Parties, including the Original Participating Manufacturers, as set forth in the Agreement; and

WHEREAS, Section XVII of the Agreement provides that the Original Participating Manufacturers shall pay reasonable attorneys' fees to those private outside counsel identified in Exhibit S to the Agreement, pursuant to the terms hereof;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the mutual agreement of the State of STATE and the Original Participating Manufacturers to the terms of the Agreement and of the mutual agreement of STATE Outside Counsel and the Original Participating Manufacturers to the terms of this STATE Fee Payment Agreement, and such other consideration described herein, the Original Participating Manufacturers and STATE Outside Counsel agree as follows:

SECTION 1. *Definitions.*

All definitions contained in the Agreement are incorporated by reference herein, except as to terms specifically defined herein.

(a) "*Action*" means the lawsuit identified in Exhibit D, M or N to the Agreement that has been brought by or against the State of STATE [or Litigating Political Subdivision].

(b) "*Allocated Amount*" means the amount of any Applicable Quarterly Payment allocated to any Private Counsel (including STATE Outside Counsel) pursuant to section 17 hereof.

(c) "*Allocable Liquidated Share*" means, in the event that the sum of all Payable Liquidated Fees of Private Counsel as of any date specified in section 8 hereof exceeds the Applicable Liquidation Amount for any payment described therein, a percentage share of the Applicable Liquidation Amount equal to the proportion of (i) the amount of the Payable Liquidated Fee of STATE Outside Counsel to (ii) the sum of Payable Liquidated Fees of all Private Counsel.

(d) "*Applicable Liquidation Amount*" means, for purposes of the payments described in section 8 hereof

(i) for the payment described in subsection (a) thereof, $125 million;

(ii) for the payment described in subsection (b) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsection (a) thereof;

(iii) for the payment described in subsection (c) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a) and (b) thereof;

(iv) for the payment described in subsection (d) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b) and (c) thereof;

(v) for the payment described in subsection (e) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel pursuant to subsections (a), (b), (c) and (d) thereof;

(vi) for each of the first, second and third quarterly payments for any calendar year described in subsection (f) thereof, $62.5 million; and

(vii) for each of the fourth calendar quarterly payments for any calendar year described in subsection (f) thereof, the difference between (A) $250 million and (B) the sum of all amounts paid in satisfaction of all Payable Liquidated Fees of Outside Counsel with respect to the preceding calendar quarters of the calendar year.

(e) "*Application*" means a written application for a Fee Award submitted to the Panel, as well as all supporting materials (which may include video recordings of interviews).

(f) "*Approved Cost Statement*" means both (i) a Cost Statement that has been accepted by the Original Participating Manufacturers; and (ii) in the event that a Cost Statement submitted by STATE Outside Counsel is disputed, the determination by arbitration pursuant to subsection (b) of section 19 hereof as to the amount of the reasonable costs and expenses of STATE Outside Counsel.

(g) "*Cost Statement*" means a signed and attested statement of reasonable costs and expenses of Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision.

(h) "*Designated Representative*" means the person designated in writing, by each person or entity identified in Exhibit S to the Agreement [by the Attorney General of the State of STATE or as later certified in writing by the governmental prosecuting authority of the Litigating Political Subdivision], to act as their agent in receiving payments from the Original Participating Manufacturers for the benefit of STATE Outside Counsel pursuant to sections 8, 16 and 19 hereof, as applicable.

(i) "*Director*" means the Director of the Private Adjudication Center of the Duke University School of Law or such other person or entity as may be chosen by agreement of the Original Participating Manufacturers and the Committee described in the second sentence of paragraph (b)(ii) of section 11 hereof.

(j) "*Eligible Counsel*" means Private Counsel eligible to be allocated a part of a Quarterly Fee Amount pursuant to section 17 hereof.

(k) "*Federal Legislation*" means federal legislation that imposes an enforceable obligation on Participating Defendants to pay attorneys' fees with respect to Private Counsel.

(l) "*Fee Award*" means any award of attorneys' fees by the Panel in connection with a Tobacco Case.

(m) "*Liquidated Fee*" means an attorneys' fee for Outside Counsel for any action identified on Exhibit D, M or N to the Agreement that has been brought by or against a Settling State or Litigating Political Subdivision, in an amount agreed upon by the Original Participating Manufacturers and such Outside Counsel.

(n) "*Outside Counsel*" means all those Private Counsel identified in Exhibit S to the Agreement.

(o) "*Panel*" means the three-member arbitration panel described in section 11 hereof.

(p) "*Party*" means (i) STATE Outside Counsel and (ii) an Original Participating Manufacturer.

(q) "*Payable Cost Statement*" means the unpaid amount of a Cost Statement as to which all conditions precedent to payment have been satisfied.

(r) "*Payable Liquidated Fee*" means the unpaid amount of a Liquidated Fee as to which all conditions precedent to payment have been satisfied.

(s) "*Previously Settled States*" means the States of Mississippi, Florida and Texas.

(t) "*Private Counsel*" means all private counsel for all plaintiffs in a Tobacco Case (including STATE Outside Counsel).

(u) "*Quarterly Fee Amount*" means, for purposes of the quarterly payments described in sections 16, 17 and 18 hereof

(i) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 1999 and ending with the third calendar quarter of 2008, $125 million;

(ii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 1999 and ending with the fourth calendar quarter of 2003, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any;

(iii) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2004 and ending with the fourth calendar quarter of 2008, the sum of (A) $125 million; (B) the difference between (*1*) $375 million; and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any; and (C) the difference, if any, between (*1*) $250 million and (*2*) the product of (*a*) .2 (two tenths) and (*b*) the sum of all amounts paid in satisfaction of all Liquidated Fees of Outside Counsel pursuant to section 8 hereof, if any;

(iv) for each of the first, second and third calendar quarters of any calendar year beginning with the first calendar quarter of 2009, $125 million; and

(v) for each fourth calendar quarter of any calendar year beginning with the fourth calendar quarter of 2009, the sum of (A) $125 million and (B) the difference, if any, between (*1*) $375 million and (*2*) the sum of all amounts paid in satisfaction of all Fee Awards of Private Counsel during such calendar year, if any.

(v) "*Related Persons*" means each Original Participating Manufacturer's past, present and future Affiliates, divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents, auditors, advertising agencies, public relations entities, attorneys, retailers and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing).

(w) "*State of STATE*" means the [applicable Settling State or the Litigating Political Subdivision], any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and subdivisions.

(x) "*STATE Outside Counsel*" means all persons or entities identified in Exhibit S to the Agreement by the Attorney General of State of STATE [or as later certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] as having been retained by and having represented the STATE in connection with the Action, acting collectively by unanimous decision of all such persons or entities.

(y) "*Tobacco Case*" means any tobacco and health case (other than a non-class action personal injury case brought directly by or on behalf of a single natural person or the survivor of such person or for wrongful death, or any non-class action consolidation of two or more such cases).

(z) "*Unpaid Fee*" means the unpaid portion of a Fee Award.

SECTION 2. *Agreement to Pay Fees.*

The Original Participating Manufacturers will pay reasonable attorneys' fees to STATE Outside Counsel for their representation of the State of STATE in connection with the Action, as provided herein and subject to the Code of Professional Responsibility of the American Bar Association. Nothing herein shall be construed to require the Original Participating Manufacturers to pay any attorneys' fees other than (i) a Liquidated Fee or a Fee Award and (ii) a Cost Statement, as provided herein, nor shall anything herein require the Original Participating Manufacturers to pay any Liquidated Fee, Fee Award or Cost Statement in connection with any litigation other than the Action.

SECTION 3. *Exclusive Obligation of the Original Participating Manufacturers.*

The provisions set forth herein constitute the entire obligation of the Original Participating Manufacturers with respect to payment of attorneys' fees of STATE Outside Counsel (including costs and expenses) in connection with the Action and the exclusive means by which STATE Outside Counsel or any other person or entity may seek payment of fees by the Original Participating Manufacturers or Related Persons in connection with the Action. The Original Participating Manufacturers shall have no obligation pursuant to Section XVII of the Agreement to pay attorneys' fees in connection with the Action to any counsel other than STATE Outside Counsel, and they shall have no other obligation to pay attorneys' fees to or otherwise to compensate STATE Outside Counsel, any other counsel or representative of the State of STATE or the State of STATE itself with respect to attorneys' fees in connection with the Action.

SECTION 4. *Release.*

(a) Each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] hereby irrevocably releases the Original Participating Manufacturers and all Related Persons from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

(b) In the event that STATE Outside Counsel and the Original Participating Manufacturers agree upon a Liquidated Fee pursuant to section 7 hereof, it shall be a precondition to any payment by the Original Participating Manufacturers to the Designated Representative pursuant to section 8 hereof that each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority for the Litigating Political Subdivision] shall have irrevocably released all entities represented by STATE Outside Counsel in the Action, as well as all persons acting by or on behalf of such entities (including the Attorney General [or the office of the governmental prosecuting authority] and each other person or entity identified on Exhibit S to the Agreement by the Attorney General [or the office of the governmental prosecuting authority]) from any and all claims that such person or entity ever had, now has or hereafter can, shall or may have in any way related to the Action (including but not limited to any negotiations related to the settlement of the Action). Such release shall not be construed as a release of any person or entity as to any of the obligations undertaken herein in connection with a breach thereof.

SECTION 5. *No Effect on STATE Outside Counsel's Fee Contract.*

The rights and obligations, if any, of the respective parties to any contract between the State of STATE and STATE Outside Counsel shall be unaffected by this STATE Fee Payment Agreement except (a) insofar as STATE Outside Counsel grant the release described in subsection (b) of section 4 hereof; and (b) to the extent that STATE Outside Counsel receive any payments in satisfaction of a Fee Award pursuant to section 16 hereof, any amounts so received shall be credited, on a dollar-for-dollar basis, against any amount payable to STATE Outside Counsel by the State of STATE [or the Litigating Political Subdivision] under any such contract.

SECTION 6. *Liquidated Fees.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel agree upon the amount of a Liquidated Fee, the Original Participating Manufacturers shall pay such Liquidated Fee, pursuant to the terms hereof.

(b) The Original Participating Manufacturers' payment of any Liquidated Fee pursuant to this STATE Fee Payment Agreement shall be subject to (i) satisfaction of the conditions precedent stated in section 4 and paragraph (c)(ii) of section 7 hereof; and (ii) the payment schedule and the annual and quarterly aggregate national caps specified in sections 8 and 9 hereof, which shall apply to all payments made with respect to Liquidated Fees of all Outside Counsel.

SECTION 7. *Negotiation of Liquidated Fees.*

(a) If STATE Outside Counsel seek to be paid a Liquidated Fee, the Designated Representative shall so notify the Original Participating Manufacturers. The Original Participating Manufacturers may at any time make an offer of a Liquidated Fee to the Designated Representative in an amount set by the unanimous agreement, and at the sole discretion, of the Original Participating Manufacturers and, in any event, shall collectively make such an offer to the Designated Representative no more than 60 Business Days after receipt of notice by the Designated Representative that STATE Outside Counsel seek to be paid a Liquidated Fee. The Original Participating Manufacturers shall not be obligated to make an offer of a Liquidated Fee in any particular amount. Within ten Business Days after receiving such an offer, STATE Outside Counsel shall either accept the offer, reject the offer or make a counteroffer.

(b) The national aggregate of all Liquidated Fees to be agreed to by the Original Participating Manufacturers in connection with the settlement of those actions indicated on Exhibits D, M and N to the Agreement shall not exceed one billion two hundred fifty million dollars ($1,250,000,000).

(c) If the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee:

(i) STATE Outside Counsel shall not be eligible for a Fee Award;

(ii) such Liquidated Fee shall not become a Payable Liquidated Fee until such time as (A) State-Specific Finality has occurred in the State of STATE; (B) each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the office of the governmental prosecuting authority of the Litigating Political Subdivision] has granted the release described in subsection (b) of section 4 hereof; and (C) notice of the events described in subparagraphs (A) and (B) of this paragraph has been provided to the Original Participating Manufacturers.

(iii) payment of such Liquidated Fee pursuant to sections 8 and 9 hereof (together with payment of costs and expenses pursuant to section 19 hereof), shall be STATE Outside Counsel's total and sole compensation by the Original Participating Manufacturers in connection with the Action.

(d) If the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee, STATE Outside Counsel may submit an Application to the Panel for a Fee Award to be paid as provided in sections 16, 17 and 18 hereof.

SECTION 8. *Payment of Liquidated Fee.*

In the event that the Original Participating Manufacturers and STATE Outside Counsel agree in writing upon a Liquidated Fee, and until such time as the Designated Representative has received payments in full satisfaction of such Liquidated Fee —

(a) On February 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before January 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of January 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(b) On August 1, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after January 15, 1999 and before July 15, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after January 15, 1999 and before July 15, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(c) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee on or after July 15, 1999 and before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees on or after July 15, 1999 and before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(d) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel, or (ii) $5 million or (iii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that become Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(e) On December 15, 1999, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee before December 1, 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel that became Payable Liquidated Fees before December 1, 1999 exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

(f) On the last day of each calendar quarter, beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, if the Liquidated Fee of STATE Outside Counsel became a Payable Liquidated Fee at least 15 Business Days prior to the last day of each such calendar quarter, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the lesser of (i) the Payable Liquidated Fee of STATE Outside Counsel or (ii) in the event that the sum of all Payable Liquidated Fees of all Outside Counsel as of the date 15 Business Days prior to the date of the payment in question exceeds the Applicable Liquidation Amount, the Allocable Liquidated Share of STATE Outside Counsel.

SECTION 9. *Limitations on Payments of Liquidated Fees.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Liquidated Fees shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make any payment that would result in aggregate national payments of Liquidated Fees:

(i) during 1999, totaling more than $250 million;

(ii) with respect to any calendar quarter beginning with the first calendar quarter of 2000 and ending with the fourth calendar quarter of 2003, totaling more than $62.5 million, except to the extent that a payment with respect to any prior calendar quarter of any calendar year did not total $62.5 million; or

(iii) with respect to any calendar quarter after the fourth calendar quarter of 2003, totaling more than zero.

(b) The Original Participating Manufacturers' obligations with respect to the Liquidated Fee of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, such Liquidated Fee shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 10. *Fee Awards.*

(a) In the event that the Original Participating Manufacturers and STATE Outside Counsel do not agree in writing upon a Liquidated Fee as described in section 7 hereof, the Original Participating Manufacturers shall pay, pursuant to the terms hereof, the Fee Award awarded by the Panel to STATE Outside Counsel.

(b) The Original Participating Manufacturers' payment of any Fee Award pursuant to this STATE Fee Payment Agreement shall be subject to the payment schedule and the annual and quarterly aggregate national caps specified in sections 17 and 18 hereof, which shall apply to:

(i) all payments of Fee Awards in connection with an agreement to pay fees as part of the settlement of any Tobacco Case on terms that provide for payment by the Original Participating Manufacturers or other defendants acting in agreement with the Original Participating Manufacturers (collectively, "Participating Defendants") of fees with respect to any Private Counsel, subject to an annual cap on payment of all such fees; and

(ii) all payments of attorneys' fees (other than fees for attorneys of Participating Defendants) pursuant to Fee Awards for activities in connection with any Tobacco Case resolved by operation of Federal Legislation.

SECTION 11. *Composition of the Panel.*

(a) The first and the second members of the Panel shall both be permanent members of the Panel and, as such, will participate in the determination of all Fee Awards. The third Panel member shall not be a permanent Panel member, but instead shall be a state-specific member selected to determine Fee Awards on behalf of Private Counsel retained in connection with litigation within a single state. Accordingly, the third, state-specific member of the Panel for purposes of determining Fee Awards with respect to litigation in the State of STATE shall not participate in any determination as to any Fee Award with respect to litigation in any other state (unless selected to participate in such determinations by such persons as may be authorized to make such selections under other agreements).

(b) The members of the Panel shall be selected as follows:

(i) The first member shall be the natural person selected by Participating Defendants.

(ii) The second member shall be the person jointly selected by the agreement of Participating Defendants and a majority of the committee described in the fee payment agreements entered in connection with the settlements of the Tobacco Cases brought by the Previously Settled States. In the event that the person so selected is unable or unwilling to continue to serve, a replacement for such member shall be selected by agreement of the Original Participating Manufacturers and a majority of the members of a committee composed of the following members: Joseph F. Rice, Richard F. Scruggs, Steven W. Berman, Walter Umphrey, one additional representative, to be selected in the sole discretion of NAAG, and two representatives of Private Counsel in Tobacco Cases, to be selected at the sole discretion of the Original Participating Manufacturers.

(iii) The third, state-specific member for purposes of determining Fee Awards with respect to litigation in the State of STATE shall be a natural person selected by STATE Outside Counsel, who shall notify the Director and the Original Participating Manufacturers of the name of the person selected.

SECTION 12. *Application of STATE Outside Counsel.*

(a) STATE Outside Counsel shall make a collective Application for a single Fee Award, which shall be submitted to the Director. Within five Business Days after receipt of the Application by STATE Outside Counsel, the Director shall serve the Application upon the Original Participating Manufacturers and the STATE. The Original Participating Manufacturers shall

submit all materials in response to the Application to the Director by the later of (i) 60 Business Days after service of the Application upon the Original Participating Manufacturers by the Director, (ii) five Business Days after the date of State-Specific Finality in the State of STATE or (iii) five Business Days after the date on which notice of the name of the third, state-specific panel member described in paragraph (b)(iii) of section 11 hereof has been provided to the Director and the Original Participating Manufacturers.

(b) The Original Participating Manufacturers may submit to the Director any materials that they wish and, notwithstanding any restrictions or representations made in any other agreements, the Original Participating Manufacturers shall be in no way constrained from contesting the amount of the Fee Award requested by STATE Outside Counsel. The Director, the Panel, the State of STATE, the Original Participating Manufacturers and STATE Outside Counsel shall preserve the confidentiality of any attorney work-product materials or other similar confidential information that may be submitted.

(c) The Director shall forward the Application of STATE Outside Counsel, as well as all written materials relating to such Application that have been submitted by the Original Participating Manufacturers pursuant to subsection (b) of this section, to the Panel within five Business Days after the later of (i) the expiration of the period for the Original Participating Manufacturers to submit such materials or (ii) the earlier of (A) the date on which the Panel issues a Fee Award with respect to any Application of other Private Counsel previously forwarded to the Panel by the Director or (B) 30 Business Days after the forwarding to the Panel of the Application of other Private Counsel most recently forwarded to the Panel by the Director. The Director shall notify the Parties upon forwarding the Application (and all written materials relating thereto) to the Panel.

(d) In the event that either Party seeks a hearing before the Panel, such Party may submit a request to the Director in writing within five Business Days after the forwarding of the Application of STATE Outside Counsel to the Panel by the Director, and the Director shall promptly forward the request to the Panel. If the Panel grants the request, it shall promptly set a date for hearing, such date to fall within 30 Business Days after the date of the Panel's receipt of the Application.

SECTION 13. *Panel Proceedings.*

The proceedings of the Panel shall be conducted subject to the terms of this Agreement and of the Protocol of Panel Procedures attached as an Appendix hereto.

SECTION 14. *Award of Fees to STATE Outside Counsel.*

The members of the Panel will consider all relevant information submitted to them in reaching a decision as to a Fee Award that fairly provides for full reasonable compensation of STATE Outside Counsel. In considering the amount of the Fee Award, the Panel shall not consider any Liquidated Fee agreed to by any other Outside Counsel, any offer of or negotiations relating to any proposed liquidated fee for STATE Outside Counsel or any Fee Award that already has been or yet may be awarded in connection with any other Tobacco Case. The Panel shall not be limited to an hourly-rate or lodestar analysis in determining the amount of the Fee Award of STATE Outside Counsel, but shall take into account the totality of the circumstances. The Panel's decisions as to the Fee Award of STATE Outside Counsel shall be in writing and shall report the amount of the fee awarded (with or without explanation or opinion, at the Panel's discretion). The Panel shall determine the amount of the Fee Award to be paid to STATE Outside Counsel within the later of 30 calendar days after receiving the Application (and all related materials) from the Director or 15 Business Days after the last date of any hearing held pursuant to subsection (d) of section 12 hereof. The Panel's decision as to the Fee Award of STATE Outside Counsel shall be final, binding and non-appealable.

SECTION 15. *Costs of Arbitration.*

All costs and expenses of the arbitration proceedings held by the Panel, including costs, expenses and compensation of the Director and of the Panel members (but not including any costs, expenses or compensation of counsel making applications to the Panel), shall be borne by the Original Participating Manufacturers in proportion to their Relative Market Shares.

SECTION 16. *Payment of Fee Award of STATE Outside Counsel.*

On or before the tenth Business Day after the last day of each calendar quarter beginning with the first calendar quarter of 1999, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Allocated Amount for STATE Outside Counsel for the calendar quarter with respect to which such quarterly payment is being made (the "Applicable Quarter").

SECTION 17. *Allocated Amounts of Fee Awards.*

The Allocated Amount for each Private Counsel with respect to any payment to be made for any particular Applicable Quarter shall be determined as follows:

(a) The Quarterly Fee Amount shall be allocated equally among each of the three months of the Applicable Quarter. The amount for each such month shall be allocated among those Private Counsel retained in connection with Tobacco Cases settled before or during such month (each such Private Counsel being an "Eligible Counsel" with respect to such monthly amount), each of which shall be allocated a portion of each such monthly amount up to (or, in the event that the sum of all Eligible Counsel's respective Unpaid Fees exceeds such monthly amount, in proportion to) the amount of such Eligible Counsel's Unpaid Fees. The monthly amount for each month of the calendar quarter shall be allocated among those Eligible Counsel having Unpaid Fees, without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter. The allocation of subsequent Quarterly Fee Amounts for the calendar year, if any, shall be adjusted, as necessary, to account for any Eligible Counsel that are granted Fee Awards in a subsequent quarter of such calendar year, as provided in paragraph (b)(ii) of this section.

(b) In the event that the amount for a given month is less than the sum of the Unpaid Fees of all Eligible Counsel:

(i) in the case of the first quarterly allocation for any calendar year, such monthly amount shall be allocated among all Eligible Counsel for such month in proportion to the amounts of their respective Unpaid Fees.

(ii) in the case of a quarterly allocation after the first quarterly allocation, the Quarterly Fee Amount shall be allocated among only those Private Counsel, if any, that were Eligible Counsel with respect to any monthly amount for any prior quarter of the calendar year but were not allocated a proportionate share of such monthly amount (either because such Private Counsel's applications for Fee Awards were still under consideration as of the last day of the calendar quarter containing the month in question or for any other reason), until each such Eligible Counsel has been allocated a proportionate share of all such prior monthly payments for the calendar year (each such share of each such Eligible Counsel being a "Payable Proportionate Share"). In the event that the sum of all Payable Proportionate Shares exceeds the Quarterly Fee Amount, the Quarterly Fee Amount shall be allocated among such Eligible Counsel on a monthly basis in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be other Eligible Counsel with respect to such prior monthly amounts that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter). In the event that the sum of all Payable Proportionate Shares is less than the Quarterly Fee Amount, the amount by which the Quarterly Fee Amount exceeds the sum of all such Payable Proportionate Shares shall be allocated among each month of the calendar quarter, each such monthly amount to be allocated among those Eligible Counsel having Unpaid Fees in proportion to the amounts of their respective Unpaid Fees (without regard to whether there may be Eligible Counsel that have not yet been granted or denied a Fee Award as of the last day of the Applicable Quarter).

(c) Adjustments pursuant to subsection (b)(ii) of this section 17 shall be made separately for each calendar year. No amounts paid in any calendar year shall be subject to refund, nor shall any payment in any given calendar year affect the allocation of payments to be made in any subsequent calendar year.

SECTION 18. *Credits to and Limitations on Payment of Fee Awards.*

Notwithstanding any other provision hereof, all payments by the Original Participating Manufacturers with respect to Fee Awards shall be subject to the following:

(a) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments and credits by Participating Defendants with respect to all Fee Awards of Private Counsel:

(i) during any year beginning with 1999, totaling more than the sum of the Quarterly Fee Amounts for each calendar quarter of the calendar year, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999; and

(ii) during any calendar quarter beginning with the first calendar quarter of 1999, totaling more than the Quarterly Fee Amount for such quarter, excluding certain payments with respect to any Private Counsel for 1998 that are paid in 1999.

(b) The Original Participating Manufacturers' obligations with respect to the Fee Award of STATE Outside Counsel, if any, shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law,

such Fee Award shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other encumbrance.

SECTION 19. *Reimbursement of Outside Counsel's Costs.*

(a) The Original Participating Manufacturers shall reimburse STATE Outside Counsel for reasonable costs and expenses incurred in connection with the Action, provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers ordinarily reimburse their own counsel or agents. Payment of any Approved Cost Statement pursuant to this STATE Fee Payment Agreement shall be subject to (i) the condition precedent of approval of the Agreement by the Court for the State of STATE and (ii) the payment schedule and the aggregate national caps specified in subsection (c) of this section, which shall apply to all payments made with respect to Cost Statements of all Outside Counsel.

(b) In the event that STATE Outside Counsel seek to be reimbursed for reasonable costs and expenses incurred in connection with the Action, the Designated Representative shall submit a Cost Statement to the Original Participating Manufacturers. Within 30 Business Days after receipt of any such Cost Statement, the Original Participating Manufacturers shall either accept the Cost Statement or dispute the Cost Statement, in which event the Cost Statement shall be subject to a full audit by examiners to be appointed by the Original Participating Manufacturers (in their sole discretion). Any such audit will be completed within 120 Business Days after the date the Cost Statement is received by the Original Participating Manufacturers. Upon completion of such audit, if the Original Participating Manufacturers and STATE Outside Counsel cannot agree as to the appropriate amount of STATE Outside Counsel's reasonable costs and expenses, the Cost Statement and the examiner's audit report shall be submitted to the Director for arbitration before the Panel or, in the event that STATE Outside Counsel and the Original Participating Manufacturers have agreed upon a Liquidated Fee pursuant to section 7 hereof, before a separate three-member panel of independent arbitrators, to be selected in a manner to be agreed to by STATE Outside Counsel and the Original Participating Manufacturers, which shall determine the amount of STATE Outside Counsel's reasonable costs and expenses for the Action. In determining such reasonable costs and expenses, the members of the arbitration panel shall be governed by the Protocol of Panel Procedures attached as an Appendix hereto. The amount of STATE Outside Counsel's reasonable costs and expenses determined pursuant to arbitration as provided in the preceding sentence shall be final, binding and non-appealable.

(c) Any Approved Cost Statement of STATE Outside Counsel shall not become a Payable Cost Statement until approval of the Agreement by the Court for the State of STATE. Within five Business Days after receipt of notification thereof by the Designated Representative, each Original Participating Manufacturer shall severally pay to the Designated Representative its Relative Market Share of the Payable Cost Statement of STATE Outside Counsel, subject to the following:

(i) All Payable Cost Statements of Outside Counsel shall be paid in the order in which such Payable Cost Statements became Payable Cost Statements.

(ii) Under no circumstances shall the Original Participating Manufacturers be required to make payments that would result in aggregate national payments by Participating Defendants of all Payable Cost Statements of Private Counsel in connection with all of the actions identified in Exhibits D, M and N to the Agreement, totaling more than $75 million for any given year.

(iii) Any Payable Cost Statement of Outside Counsel not paid during the year in which it became a Payable Cost Statement as a result of paragraph (ii) of this subsection shall become payable in subsequent years, subject to paragraphs (i) and (ii), until paid in full.

(d) The Original Participating Manufacturers' obligations with respect to reasonable costs and expenses incurred by STATE Outside Counsel in connection with the Action shall be exclusively as provided in this STATE Fee Payment Agreement, and notwithstanding any other provision of law, any Approved Cost Statement determined pursuant to subsection (b) of this section (including any Approved Cost Statement determined pursuant to arbitration before the Panel or the separate three-member panel of independent arbitrators described therein) shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other incumbrance.

SECTION 20. *Distribution of Payments among STATE Outside Counsel.*

(a) All payments made to the Designated Representative pursuant to this STATE Fee Payment Agreement shall be for the benefit of each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], each of which shall receive from the

Designated Representative a percentage of each such payment in accordance with the fee sharing agreement, if any, among STATE Outside Counsel (or any written amendment thereto).

(b) The Original Participating Manufacturers shall have no obligation, responsibility or liability with respect to the allocation among those persons or entities identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], or with respect to any claim of misallocation, of any amounts paid to the Designated Representative pursuant to this STATE Fee Payment Agreement.

SECTION 21. *Calculations of Amounts.*

All calculations that may be required hereunder shall be performed by the Original Participating Manufacturers, with notice of the results thereof to be given promptly to the Designated Representative. Any disputes as to the correctness of calculations made by the Original Participating Manufacturers shall be resolved pursuant to the procedures described in Section XI(c) of the Agreement for resolving disputes as to calculations by the Independent Auditor.

SECTION 22. *Payment Responsibility.*

(a) Each Original Participating Manufacturer shall be severally liable for its share of all payments pursuant to this STATE Fee Payment Agreement. Under no circumstances shall any payment due hereunder or any portion thereof become the joint obligation of the Original Participating Manufacturers or the obligation of any person other than the Original Participating Manufacturer from which such payment is originally due, nor shall any Original Participating Manufacturer be required to pay a portion of any such payment greater than its Relative Market Share.

(b) Due to the particular corporate structures of R. J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("Brown & Williamson") with respect to their non-domestic tobacco operations, Reynolds and Brown & Williamson shall each be severally liable for its respective share of each payment due pursuant to this STATE Fee Payment Agreement up to (and its liability hereunder shall not exceed) the full extent of its assets used in, and earnings and revenues derived from, its manufacture and sale in the United States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of its other assets or earnings to satisfy such obligations.

SECTION 23. *Termination.*

In the event that the Agreement is terminated with respect to the State of STATE pursuant to Section XVIII(u) of the Agreement (or for any other reason) the Designated Representative and each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision] shall immediately refund to the Original Participating Manufacturers all amounts received under this STATE Fee Payment Agreement.

SECTION 24. *Intended Beneficiaries.*

No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the State of STATE. Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.

SECTION 25. *Representations of Parties.*

The Parties hereto hereby represent that this STATE Fee Payment Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the Parties hereto.

SECTION 26. *No Admission.*

This STATE Fee Payment Agreement is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or wrongdoing whatsoever on the part of any signatory hereto or any person covered by either of the releases provided under section 4 hereof. The Original Participating Manufacturers specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the claims released under section 4 hereof and enter into this STATE Fee Payment Agreement for the sole purposes of memorializing the Original Participating Manufacturers' rights and obligations with respect to payment of attorneys' fees pursuant to the Agreement and avoiding the further expense, inconvenience, burden and uncertainty of potential litigation.

SECTION 27. *Non-admissibility.*

This STATE Fee Payment Agreement having been undertaken by the Parties hereto in good faith and for settlement purposes only, neither this STATE Fee Payment Agreement nor any evidence of negotiations relating hereto shall be offered or received in evidence in any action or proceeding other than an action or proceeding arising under this STATE Fee Payment Agreement.

SECTION 28. *Amendment and Waiver.*

This STATE Fee Payment Agreement may be amended only by a written instrument executed by the Parties. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving Party.

The waiver by any Party of any breach hereof shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this STATE Fee Payment Agreement.

SECTION 29. *Notices.*

All notices or other communications to any party hereto shall be in writing (including but not limited to telex, facsimile or similar writing) and shall be given to the notice parties listed on Schedule A hereto at the addresses therein indicated. Any Party hereto may change the name and address of the person designated to receive notice on behalf of such Party by notice given as provided in this section including an updated list conformed to Schedule A hereto.

SECTION 30. *Governing Law.*

This STATE Fee Payment Agreement shall be governed by the laws of the State of STATE without regard to the conflict of law rules of such State.

SECTION 31. *Construction.*

None of the Parties hereto shall be considered to be the drafter hereof or of any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

SECTION 32. *Captions.*

The captions of the sections hereof are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 33. *Execution of STATE Fee Payment Agreement.*

This STATE Fee Payment Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this STATE Fee Payment Agreement.

SECTION 34. *Entire Agreement of Parties.*

This STATE Fee Payment Agreement contains an entire, complete and integrated statement of each and every term and provision agreed to by and among the Parties with respect to payment of attorneys' fees by the Original Participating Manufacturers in connection with the Action and is not subject to any condition or covenant, express or implied, not provided for herein.

IN WITNESS WHEREOF, the Parties hereto, through their fully authorized representatives, have agreed to this STATE Fee Payment Agreement as of this ___th day of _, 1998.

[SIGNATURE BLOCK]

APPENDIX
to MODEL FEE PAYMENT AGREEMENT
PROTOCOL OF PANEL PROCEEDINGS

This Protocol of procedures has been agreed to between the respective parties to the STATE Fee Payment Agreement, and shall govern the arbitration proceedings provided for therein.

SECTION 1. *Definitions.*

All definitions contained in the STATE Fee Payment Agreement are incorporated by reference herein.

SECTION 2. *Chairman.*

The person selected to serve as the permanent, neutral member of the Panel as described in paragraph (b)(ii) of section 11 of the STATE Fee Payment Agreement shall serve as the Chairman of the Panel.

SECTION 3. *Arbitration Pursuant to Agreement.*

The members of the Panel shall determine those matters committed to the decision of the Panel under the STATE Fee Payment Agreement, which shall govern as to all matters discussed therein.

SECTION 4. *ABA Code of Ethics.*

Each of the members of the Panel shall be governed by the Code of Ethics for Arbitrators in Commercial Disputes prepared by the American Arbitration Association and the American Bar Association (the "Code of Ethics") in conducting the arbitration proceedings pursuant to the STATE Fee Payment Agreement, subject to the terms of the STATE Fee Payment Agreement and this Protocol. Each of the party-appointed members of the Panel shall be governed by Canon VII of the Code of Ethics. No person may engage in any ex parte communications with the permanent, neutral member of the Panel selected pursuant to paragraph (b)(ii) of section 11, in keeping with Canons I, II and III of the Code of Ethics.

SECTION 5. *Additional Rules and Procedures.*

The Panel may adopt such rules and procedures as it deems necessary and appropriate for the discharge of its duties under the STATE Fee Payment Agreement and this Protocol, subject to the terms of the STATE Fee Payment Agreement and this Protocol.

SECTION 6. *Majority Rule.*

In the event that the members of the Panel are not unanimous in their views as to any matter to be determined by them pursuant to the STATE Fee Payment Agreement or this Protocol, the determination shall be decided by a vote of a majority of the three members of the Panel.

SECTION 7. *Application for Fee Award and Other Materials.*

(a) The Application of STATE Outside Counsel and any materials submitted to the Director relating thereto (collectively, "submissions") shall be forwarded by the Director to each of the members of the Panel in the manner and on the dates specified in the STATE Fee Payment Agreement.

(b) All materials submitted to the Director by either Party (or any other person) shall be served upon all Parties. All submissions required to be served on any Party shall be deemed to have been served as of the date on which such materials have been sent by either (i) hand delivery or (ii) facsimile and overnight courier for priority next-day delivery.

(c) To the extent that the Panel believes that information not submitted to the Panel may be relevant for purposes of determining those matters committed to the decision of the Panel under the terms of the STATE Fee Payment Agreement, the Panel shall request such information from the Parties.

SECTION 8. *Hearing.*

Any hearing held pursuant to section 12 of the STATE Fee Payment Agreement shall not take place other than in the presence of all three members of the Panel upon notice and an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Miscellaneous.*

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers on a basis to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all media inquiries regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall refrain from any comment as to the arbitration proceedings to be conducted pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon IV(B) of the Code of Ethics.

EXHIBIT P
NOTICES

[Intentionally Omitted]

EXHIBIT Q
1996 AND 1997 DATA

(1) 1996 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	$801,640,000
Lorillard Tobacco Co.	$719,100,000
Philip Morris Inc.	$4,206,600,000
R.J. Reynolds Tobacco Co.	$1,468,000,000
Total (Base Operating Income)	$7,195,340,000

(2) 1997 volume (as measured by shipments of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,911,000,000
Lorillard Tobacco Co.	42,288,000,000
Philip Morris Inc.	236,203,000,000
R.J. Reynolds Tobacco Co.	118,254,000,000
Total (Base Volume)	475,656,000,000

(3) 1997 volume (as measured by excise taxes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,758,000,000
Lorillard Tobacco Co.	42,315,000,000
Philip Morris Inc.	236,326,000,000
R.J. Reynolds Tobacco Co.	119,099,000,000

* The volume includes 2,847,595 pounds of "roll your own" tobacco converted into the number of Cigarettes using 0.0325 ounces per Cigarette conversion factor.

EXHIBIT R
EXCLUSION OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation
GPC
State Express 555
Riviera

Philip Morris Incorporated
Players
B&H
Belmont
Mark Ten
Viscount
Accord
L&M
Lark
Rothman's
Best Buy
Bronson
F&L
Genco
GPA
Gridlock
Money
No Frills
Generals
Premium Buy
Shenandoah
Top Choice

Lorillard Tobacco Company
None

R.J. Reynolds Tobacco Company
Best Choice
Cardinal
Director's Choice
Jacks
Rainbow
Scotch Buy
Slim Price
Smoker Friendly
Valu Time
Worth

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section __. *Findings and Purpose.*[1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _____, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section __. *Definitions.*

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

[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 particularlized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(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.

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) -

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

[2] [All per unit numbers subject to verification]

[3] [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances -

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall -

(A) be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

[4] [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed $100,000, will be paid from disbursements from the Subsection VIII(c) Account.

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APPENDIX D

CONSENT DECREE

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CONSENT DECREE

At IAS Part 56 of the Supreme Court of the State of New York, held in and for the County of New York, at the Courthouse located at 60 Centre Street, New York, New York, on the 23rd day of December, 1998

PRESENT:

HON. STEPHEN G. CRANE, Justice

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE STATE OF NEW YORK and DENNIS C. VACCO, Attorney General of the State of New York, for and on behalf of the PEOPLE OF THE STATE OF NEW YORK,

Plaintiffs,

-against-

PHILIP MORRIS INCORPORATED; PHILIP MORRIS COMPANIES, INC.; RJR NABISCO, INC.; RJR NABISCO HOLDINGS CORP.; R.J. REYNOLDS TOBACCO CO.; THE AMERICAN TOBACCO CO., INC.; AMERICAN BRANDS, INC.; BROWN & WILLIAMSON TOBACCO CORP.; LORILLARD TOBACCO COMPANY; LORILLARD INCORPORATED; LOEWS CORPORATION; UNITED STATES TOBACCO COMPANY; UST, INC.; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; BATUS HOLDINGS, INC.; THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC.; and TOBACCO INSTITUTE, INC.,

Defendants.

CONSENT DECREE AND FINAL JUDGMENT

Index No.: 400361/97
Hon. Stephen G. Crane, Justice.

WHEREAS, Plaintiffs, the State of New York and Attorney General Dennis C. Vacco, commenced this action on January 27, 1997, pursuant to their common law powers and the provisions of N.Y. Executive Law, Public Health Law, General Business Law, Business Corporations Law, Penal Law, Social Services Law, Not-for-Profit Corporations Law, Unconsolidated Law, the Civil Practice Law and Rules, and the State Constitution;

WHEREAS, Plaintiffs asserted various claims for monetary, equitable and injunctive relief, on behalf of the State of New York, including its Counties under GBL §342-b, against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint and amended complaint and denied the State's allegations;

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this county.

II. DEFINITIONS

The definitions set forth in the Master Settlement Agreement (''MSA'' or ''Agreement'') (a copy of which is attached hereto as Exhibit 1) are incorporated herein by reference. ''County'' means a county of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; ''Counties'' means the counties of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; provided, however, that any county that properly excludes itself from the class provisionally certified for settlement purposes only by this Court's Order of November 24, 1998 (the ''Class'') is not included in the definitions of ''County'' or ''Counties.''

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of New York or a Released Party. The State of New York may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment. Provided, however, that a County or Counties may enforce the payment rights provided in Article V of this Consent Decree and Final Judgment, but only against other Counties or the State. Only the State may enforce the provisions of Article V against the Participating Manufacturers.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. MONETARY RELIEF

A. Under subsections II(r), (s), IX, and XI of the MSA, payments from the Participating Manufacturers will be made to the Escrow Agent for further disbursement, pursuant to an Escrow Agreement executed by the parties and approved by a Court of competent jurisdiction. The State shall instruct the Independent Auditor and the Escrow Agent to disburse funds from the New York State-Specific Account directly to the State of New York and directly to the Counties individually according to the payment schedule annexed hereto as Exhibit 2.

B. The payment schedule set forth in Exhibit 2 shall remain in effect for as long as payments are made from the Participating Manufacturers under the MSA. The portion of those payments credited to the New York State-Specific Account, if any, shall be allocable to the State of New York and the individual Counties as set forth in Exhibit 2.

C. Effective upon the occurrence of State-Specific Finality in the State of New York, and to the extent that such claims may not otherwise be released by operation of the MSA, the Counties (as defined in this Consent Decree and Final Judgment) hereby absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Counties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall, or may have, to the same extent that the Settling States are releasing Released Claims against Released Parties under the MSA.

D. Each County (as defined in this Consent Decree and Final Judgment) further covenants and agrees that it shall not after the occurrence of State-Specific Finality in the State of New York sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

E. Upon the occurrence of State-Specific Finality in the State of New York, the City of New York (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of the action entitled *City of New York et al. v. The Tobacco Institute, Inc. et al.,* Supreme Court of the State of New York, County of New York, Index No. 406225/96, and the County of Erie (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of its action entitled *County of Erie v. The Tobacco Institute, Inc. et al.,* Supreme Court of the State of New York, County of Erie, Index No. 1997/359.

F. If a County or Counties properly excludes itself from the Class, such County or Counties shall not receive any funds under the MSA, and the State may, in its sole discretion, place the funds allocated to such County or Counties under Exhibit 2 to this Consent Decree And Final Judgment in escrow.

G. If any funds are recouped from the State of New York by the Federal Government, pursuant to an Act of Congress or otherwise, from monies received or to be received by the State (including its political subdivisions) from the New York State-Specific Account, then the State shall recoup from the Counties the Counties' share of such funds, through offsets or any other mechanisms selected by the State, according to the allocation percentages of the settlement funds in the year or years in question assigned to the respective Counties pursuant to the allocation schedule set forth in Exhibit 2. Nothing herein acknowledges a right of the Federal Government to recoup any such funds.

VI. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of New York in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of New York.

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of New York any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of New York any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of New York, any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of New York any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any

package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VII. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of New York and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of New York and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. A County may apply for further orders and directions as may be necessary or appropriate for the implementation or enforcement of the fourth sentence of Article III(B) of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections VI(A) and VI(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations

asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI, VII and VIII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of New York and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of New York and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred only by the State of New York in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of New York may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for New York to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of New York of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of New York or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection VI(A) or VI(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VIII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the persons signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of New York and the Counties.

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this 23rd day of December, 1998

/s/ SGC
J.S.C.

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

At all times and under all circumstances specified in Section XI of the Master Settlement Agreement that require the Independent Auditor to instruct the Escrow Agent to disburse amounts to the State of New York pursuant to the terms of the Master Settlement Agreement (''New York Disbursal Share''), the Independent Auditor shall allocate all such New York Disbursal Share among the State of New York, the City of New York[1], and the individual counties of New York according to the schedule set forth below and instruct the Escrow Agent to disburse such allocated amounts directly to the State of New York, the City of New York and the specified counties.

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Section IX(b) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows:

Entity	Percentage of Payment
New York State	51.176%
New York City	26.670%
Albany	0.593%
Allegheny	0.107%
Broome	0.446%
Cattaraugus	0.179%
Cayuga	0.166%
Chautauqua	0.308%
Chemung	0.212%
Chenango	0.104%
Clinton	0.170%
Columbia	0.126%
Cortland	0.100%
Delaware	0.101%
Dutchess	0.500%
Erie	2.194%
Essex	0.075%
Franklin	0.098%
Fulton	0.121%
Genessee	0.118%
Greene	0.085%
Hamilton	0.013%
Herkimer	0.142%
Jefferson	0.190%
Lewis	0.054%
Livingston	0.112%
Madison	0.131%
Monroe	1.536%
Montgomery	0.114%
Nassau	2.739%
Niagara	0.467%

[1]The City of New York includes the five individual boroughs of Manhattan, Bronx, Brooklyn, Queens and Staten Island, and the New York City Health and Hospitals Corporation.

Entity	Percentage of Payment
Oneida	0.544%
Onondaga	0.972%
Ontario	0.181%
Orange	0.564%
Orleans	0.078%
Oswego	0.239%
Otsego	0.122%
Putnam	0.152%
Rensselaer	0.317%
Rockland	0.560%
St. Lawrence	0.239%
Saratoga	0.304%
Schenectady	0.319%
Schoharie	0.063%
Schuyler	0.038%
Seneca	0.069%
Steuben	0.211%
Suffolk	2.673%
Sullivan	0.155%
Tioga	0.100%
Tompkins	0.170%
Ulster	0.334%
Warren	0.113%
Washington	0.113%
Wayne	0.172%
Westchester	1.926%
Wyoming	0.081%
Yates	0.044%

(2) With respect to amounts paid by the Participating Manufacturers pursuant to Section IX(c)(2) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse the entire proceeds to the State of New York.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. STEPHEN G. CRANE Part 56
Justice

THE STATE OF NEW YORK, et al.,

Plaintiff,

- v -

PHILIP MORRIS, INC., et al.,

Defendants.

INDEX NO.: 400361/97
MOTION DATE: 4/13/99
MOTION SEQ. NO.: 019
MOTION CAL. NO.: 139

The following papers, numbered 1 to ____ were read on this motion to/for _____
PAPERS NUMBERED

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ _____

Answering Affidavits — Exhibits _____ _____

Replying Affidavits _____ _____

Cross-Motion: [ ] Yes [X] No

The State of New York and defendants Brown & Williamson Tobacco Corporation, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company, jointly move for an order, pursuant to CPLR 5019(a), correcting Exhibit 2 to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, so that the "Consent Decree and Final Judgment" accurately reflects the original intention of the parties and the terms of the Master Settlement Agreement with respect to the intra-State allocation of annual payments by the Participating Manufacturers pursuant to Section IX(c)(1) of the Master Settlement Agreement. The motion is granted on default.

Accordingly, it is

ORDERED that the motion is granted on default; and it is further

ORDERED that Paragraph (1) of "Exhibit 2" to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, shall be amended to read as follows:

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Sections IX(b) or IX(c)(1) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows: . . . .

The foregoing constitutes the decision and order of the court.

Dated: April 14, 1999

/s/ SGC
STEPHEN G. CRANE J.S.C.

Check One: [ ] FINAL DISPOSITION [X] NON-FINAL DISPOSITION
/s/ MDAR

APPENDIX E

GLOBAL INSIGHT REPORT

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A Forecast of U.S. Cigarette Consumption (2002-2023) for the Tobacco Settlement Financing Corporation (State of New York)

Submitted to:

Tobacco Settlement Financing Corporation (State of New York)

Prepared by:

Global Insight, Inc.

November 20, 2003

Jim Diffley
Group Managing Director

Jeannine Cataldi
Economist

Global Insight, Inc.
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Eddystone, PA 19022

(610) 490-2642

Executive Summary

Global Insight[1] has developed a cigarette consumption model based on historical U.S. data between 1965 and 2001. 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 2002 through 2023. Our Base Case Forecast indicates that total consumption in 2023 will be 284 billion cigarettes (approximately 14 billion packs), a 33% decline from the 2001 level. We also present alternative forecasts that project higher and lower paths of cigarette consumption. Under these, less likely, scenarios we forecast that by 2023 U.S. cigarette consumption could be as low as 268 billion and as high as 295 billion cigarettes. In addition, we also present scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

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

This forecast differs slightly from ones presented by DRI•WEFA in 2001 and 2002. 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. USDA has also revised its year 2001 consumption estimate upwards, to 425 billion, 6 billion higher than DRI•WEFA's estimate of 419 billion. Cigarette consumption is now estimated to have fallen to 407 billion in 2002, and is expected to further decrease to 394 billion in 2003. The former is higher than the earlier projections, but the forecasted rates of decline in cigarette consumption are greater than those in the previous forecasts. We estimate that consumption declined by 4.4% in 2002, and will decline by 3.2% in 2003. The forecast for the longer term has not been changed.

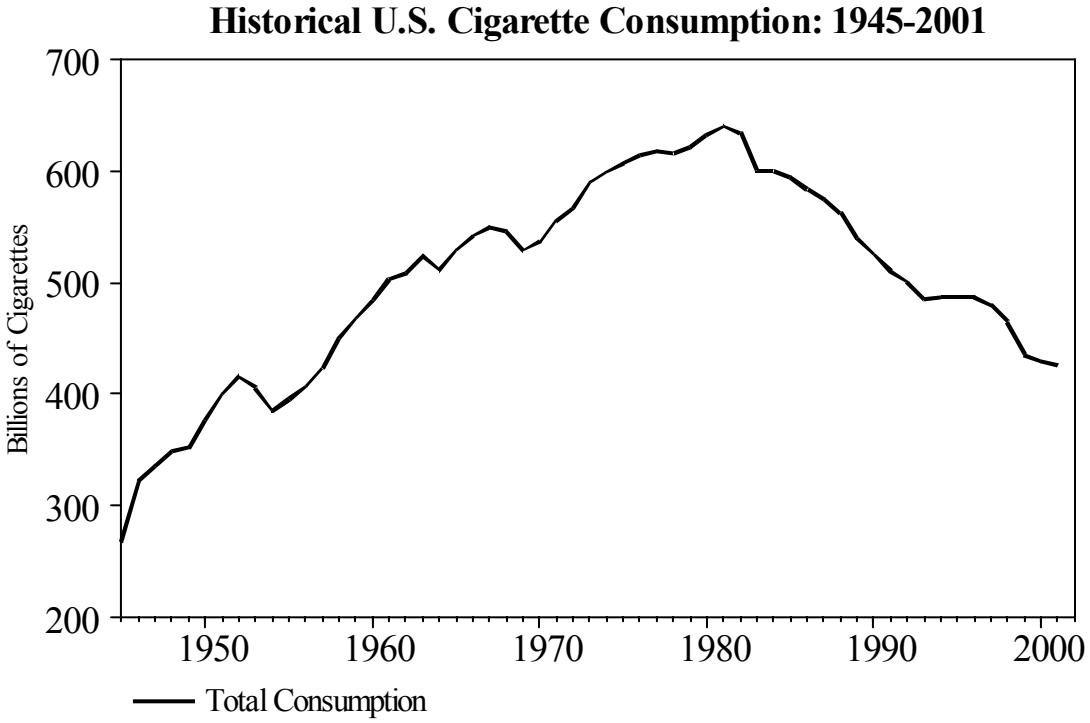
[1] On November 4, 2002, **DRI•WEFA** was re-named **Global Insight**.

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[2]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[3] as reported by the Bureau of Alcohol Tobacco and Firearms. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion in 1900 to a peak of 640 billion in 1981[4]. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998 and 425 billion cigarettes in 2001[5].



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

[2] *Source*: "Tobacco Timeline," Gene Borio (1998).
[3] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.
[4] *Source*: "Tobacco Situation and Outlook", U.S. Department of Agriculture-Economic Research Service, September 1999 (USDA-ERS).
[5] *Source*: USDA-ERS, September 2001.

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 following the Master Settlement Agreement ("MSA"). In 2000 and 2001, the rate of decline moderated, to 1.15% and 1.16%, respectively.

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

The following table sets forth United States domestic cigarette consumption for the seven years ended December 31, 2001[6]. The data in this table vary from statistics on cigarette shipments in the United States. While our Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13
1997	480	-1.44
1996	487	0.00
1995	487	0.21

[6] *Source*: USDA-ERS.

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to reports of the manufacturers, the four leading manufacturers accounted for 92.6% of U.S. shipments in 2002. These top four companies were Philip Morris, RJ Reynolds, Brown & Williamson, and Lorillard, who occupied 48.9 percent, 23.4 percent, 11.2 percent, and 9.1 percent of the domestic market respectively, as reported by each individual manufacturer. This October, a merger was proposed between RJ Reynolds and Brown & Williamson. The market share of the four leading manufacturers declined in 2002, from 93.6% in 2001. This market share is slightly less than 88% if imported cigarette shipments are included.

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 2001, the federal government received $7.5 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raise significant revenues, $8.8 billion in 2001, 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 46.2 million American adults were current smokers in 2001, representing approximately 22.8% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[7] released in October 2003. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in 1965 to 25.5% in 1990,[8] the incidence rate declined relatively slowly through the next decade. For 2000 the CDC estimates that the rate was 23.3%. The National Center for Health Statistics also presents an estimate of adult incidence for 2000 of 23.3%.[9]

[7] *Source*: CDC. Morbidity and Mortality Weekly Report, "Cigarette Smoking Among Adults – United States, 2001," October 10, 2003.
[8] *Source*: CDC, Office on Smoking and Health.

[9] *Source*: National Center for Health Statistics, National Health Interview Survey. September 20, 2001

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.[10]

The Youth Tobacco Surveillance (YTS) report, issued in November 2001 by the CDC, is a supplement to the Youth Risk Behavior Survey.[11] 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%

In November 2003, the American Legacy Foundation released results of the 2002 National Youth Tobacco Survey.[12] It found that in 2002 the prevalence of smoking by high school students had declined to 22.9%, from 28.0% in 2000. However, it found no significant decrease in the prevalence of smoking among middle school students.

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 2002 than in June 2001, the fifth consecutive annual decline. Moreover, unlike 2001, incidence levels for 10th and 12th graders are now lower than those of June 1991.[13] Smoking incidence for 8th graders had fallen below its 1991 level in 2001.

[10] *Source*: CDC, Morbidity and Mortality Weekly Report, "Trends in Cigarette Smoking Among High School Students ---United States, 1991-2001," May 17, 2002.
[11] CDC, Morbidity and Mortality Weekly Report, "Tobacco Use Among Middle and High School Students ---United States, 2002, November 14, 2003, MMWR 2003:52(No.45).
[12] CDC, CDC Surveillance Summaries, November 2, 2001, MMWR 2001:50(No.SS-4).
[13] *Source*: University of Michigan , Monitoring the Future Study, December 2002.

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

Grade	June 1991	June 2001	June 2002	'01-'02 Change (%)	'91-'02 Change (%)
8th	14.3	12.2	10.7	-12.2	-25.2
10th	20.8	21.3	17.7	-16.9	-14.9
12th	28.3	29.5	26.7	-9.5	-5.7

The 2002 National Survey on Drug Abuse and Health, formerly called National Household Survey on Drug Abuse conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services estimated that approximately 61.1 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 26.0%, which is a increase from 24.9% in 2000 and 2001. The same survey found that an estimated 13.0% of youths age 12 to 17 were current cigarette smokers in 2002, the same as in 2001, and down from 13.4% in 2000.

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.[14] (In other words, as the price of cigarettes increases by 1.0% the quantity demanded decreases by 0.3% to 0.5%.) A few researchers have estimated price elasticity as high as -1.23. Research focused on youth smoking has found price elasticity levels of up to -1.41.

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[15] 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

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

[15] *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.

cigarette consumption among high school seniors.[16] 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%."[17]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[18] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least 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. In a related study, Powell et al. (2003) estimate a price elasticity of youth smoking participation of –0.46, implying that a 10% increase in price leads to a 4.6% reduction in smoking participation.[19]

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

[16] 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.

[17] Czart et al. "The impact of prices and control policies on cigarette smoking among college students". Contemporary Economic Policy, Western Economic Association. Copyright April 2001.

[18] Tauras et al. "Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis". University of Chicago Press, Copyright 2001.

[19] Powell et al., "Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior", Impacteen, February 2003.

products. One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[20] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In October 2002, the FDA approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. It is unclear whether it offers a significant advantage over those other products.[21]

In June 2003, Pfizer Inc. announced that an experimental smoking-cessation drug, Varenicline, had passed preliminary clinical tests and would be moved into large clinical trials. The product is intended to satisfy nicotine cravings without being pleasurable or addictive. And in August 2003, Nabi Biopharmaceuticals announced the start of its Phase II clinical trial of NicVAX, a vaccine to prevent and treat nicotine addiction.

Workplace Restrictions

In their 1996 study on the effect of workplace smoking bans on cigarette consumption, Evans, Farrelly, and Montgomery found that between 1986 and 1993 smoking participation rates among workers fell 2.6% more than non-workers.[22] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10 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,

[20] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online, Tobacco Control. http:\\tc.bmjjournals.com.

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

[22] *Source*: Evans, William N.; Farrelly, Matthew C.; and Montgomery, Edward. "Do Workplace Smoking Bans Reduce Smoking*?"*. Working Paper No. W5567, National Bureau of Economic Research, 1996.

all of these factors are thought to affect smoking in some manner and to be incorporated into current levels of consumption.

General Population Growth. Global Insight forecasts that the United States population will increase from approximately 272 million in 1999 to approximately 333 million in 2023. 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. We have not yet incorporated this data into our analysis because it has yet to be reconciled by the USDA in its estimate of per capita consumption. When the correct per capita 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 Global Insight'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, Arizona, Hawaii, Massachusetts, Michigan, Nebraska, Oregon, and Tennessee imposed tax increases later in 2002. These increases range from $0.07 per

pack in Tennessee to $1.42 per pack in New York City. They average $0.47 per pack, and 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 had considered increases in excise taxes as a response to budget shortfalls following the 2001 recession.

This year excise tax increases have been enacted in Arkansas, Connecticut, Delaware, Georgia, Idaho, Montana, Nevada, New Jersey, New Mexico, Rhode Island, South Dakota, West Virginia, and Wyoming. This will result in an average price per pack that increases to around $4.00 this year. 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. Similarly, Internet sales of cigarettes are growing rapidly. While these sales are not technically exempt from taxation, states are currently having a difficult time enforcing existing statutes and collecting excise taxes on these sales.[23] Under the MSA, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume.

Changes in Disposable Income. Analyses from many conventional models also include the effect of real personal disposable income. Most studies have found cigarette consumption in the United States increases as disposable income increases.[24] However, a few studies found cigarette consumption decreases as disposable income increases.[25] Based on our multivariate regression analysis 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,[26] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[27] One study examines the effects of youth smoking on future adult smoking.[28] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there

[23] *Source*: United States General Accounting Office, "Internet Cigarette Sales", GAO-02-743, August 2002.
[24] Ippolito, et al.; Fuji.
[25] Wasserman, et al.; Townsend et al.
[26] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.
[27] *Source*: Surgeon General's 1994 Report, "Preventing Tobacco Use Among Young People."
[28] *Source*: Gruber, Jonathon and Zinman, Jonathon. "Youth Smoking in the U.S.:Evidence and Implications". Working Paper No. W7780, National Bureau of Economic Research, 2000.

are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

We have compiled data from the CDC which measures the incidence of smoking in the 12-17 age group as the percentage of the population in this category that first become daily smokers. This percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. We assume that this recent trend peaked in the late 1990s and youth smoking has resumed its longer-term decline.

Trend Over Time. Since 1964 there has been a significant decline in U.S. adult per capita cigarette consumption. The Surgeon General's health warning (1964) and numerous subsequent health warnings, together with the increased health awareness of the population over the past thirty years, may have contributed to decreases in cigarette consumption levels. If, as we assume, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. 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. On September 1 Alabama joined the other forty-nine states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[29]

On March 26, 2003, the New York State Legislature passed, and the Governor signed, legislation banning smoking in indoor workplaces, including restaurants and bars. Delaware had banned smoking in all indoor public areas in 2002. These states joined California in imposing comprehensive statewide smoking bans. The California ban has been in place since 1998. Also this year, Connecticut and Maine have passed laws which will ban smoking in restaurants and bars. The state of Florida also, as a result of a referendum in 2002, established a smoking ban this year; though it exempts some bars.

[29] *Source*: American Lung Association, "State Legislated Actions on Tobacco Issues", 2002.

Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. The state of Massachusetts and the city of Chicago are also considering these measures. A few smaller cities, including Lexington, KY, have also instituted smoking bans this year.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S.. As of October 1, 2003, there were 1,641 municipalities with indoor smoking restrictions. Of these, 266 required workplaces to be 100% smoke-free. And 100% smoke-free conditions were required for restaurants in 1493, and for bars in 107. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars. These numbers grew to 49 for restaurants, and 32 for bars in 1998, and doubled again by 2001, to 100 and 74, respectively.[30]

Based on the regression analysis using data from 1965 to 1999, the restrictions on public smoking appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970's have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. The trend variable included in our econometric analysis is likely to incorporate some part of the cumulative impact of the various smoking bans and restrictions. Our forecast assumes that the factors, which have contributed to the negative trend in smoking in the U.S. population, continue to contribute to further declines in smoking rates throughout the forecast horizon.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[31] and the American Medical Association[32] (AMA) both conclude that nicotine is an addictive drug which produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Other Considerations

In August, 1999, the CDC published Best Practices for Comprehensive Tobacco Control Programs. Citing the success of programs in California and Massachusetts, the CDC

[30] *Source:* American Nonsmokers' Rights Foundation, . October 2003
[31] *Source:* Surgeon General's 1988 Report, "The Health Consequences of Smoking – Nicotine Addiction".
[32] *Source*: Council on Scientific Affairs, "Reducing the Addictiveness of Cigarettes, "Report to the AMA House of Delegates, June 1998.

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.[33] 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.[34] 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. Most recently, on February 13, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations, which include raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to

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

[34] "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.

discourage smoking and to fund anti-tobacco efforts. Health and Human Services Secretary Thompson has indicated that administration is not contemplating the tax increase.

Neither the Surgeon General's nor the Presidential Commission's report have resulted in a concerted nationwide program to implement their recommendations. 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. A similar proposal is part of the World Health Organization's Framework Convention on Tobacco Control, which the U.S. may sign. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either greater levels of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

New York State, in 2000, mandated that manufacturers provide, beginning in 2003, only cigarettes that self-extinguish. The state's Office of Fire Prevention and Control published proposed regulations on December 31, 2002 that would require the use of 'banded' paper in cigarettes. The New York State Department of State set November 3, 2003 as the final date to receive comments on the regulations. It expects the final regulations to be issued by the end of December. Not later than six months following their issuance, all cigarettes offered for sale in the state must meet those standards. We do not believe that the New York statute or a nationwide agreement on such standards will affect consumption noticeably. It will probably raise the cost of manufacture slightly, but we view it as a continuation of a long series of government actions that contribute to the trend decline in consumption, which has been incorporated into our model. The expense and availability of technology required in the manufacture of self-extinguishing cigarettes may put the smaller manufacturers at a slight competitive disadvantage, as their cost per pack would increase more relative to the cost per pack increase for the larger manufacturers. The banded paper proposal would disadvantage the smaller manufacturers initially to the extent that it is costly to produce cigarettes solely for the New York market.

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

in consumption incorporated into our model. In our forecast, we expect such efforts to continue to reduce per capita cigarette consumption.

An Empirical Model of Cigarette Consumption

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

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

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with Global Insight's standard adult population growth, and adjustment for non-adult smoking, we projected actual cigarette consumption (in billions of cigarettes) out to 2023. 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.

log (cpc)	=	53.3410	-	0.02316 * trend
	-	0.21193 * log (cigprice)	-	0.09367 * log (cigprice)(-1)
	+	0.26979 * log (ydp96pc)	-	0.01901 * smokeban

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

This model has an R-square in excess of 0.99, meaning that it explains more than 99 per cent of the variation in U.S. 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 4.44 billion in 2023.

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) per cent 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 Global Insight forecasts. Annual population growth is projected to average 0.8%, and real per capita personal disposable income is projected to increase over the long term at just over 2.2% 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, brought the retail price at the end of 2002 to $3.83. For the year 2002 the average price per pack was $3.71, and our consumption model anticipates that that this will increase further, to $3.98 in 2003. This increase is primarily due to state excise tax increases. These increases have resulted in retail price growth in excess of 7% 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 continue to be less aggressive in raising prices in the short term as well; indeed, they increased cents-off promotional expenditures this year, in order to compensate for the state actions which reduce cigarette demand. At the same

time, coincidentally, payments due under the MSA have now fallen because the last initial payment was scheduled 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 $10 by 2023, which is $5.90 in 2000 dollars. Relative to other goods, cigarette prices will rise by an average of 2.65% 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 2023 we assume that youth smoking will have declined at an average annual rate of 1.3% since 2001, or by 25% overall.

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

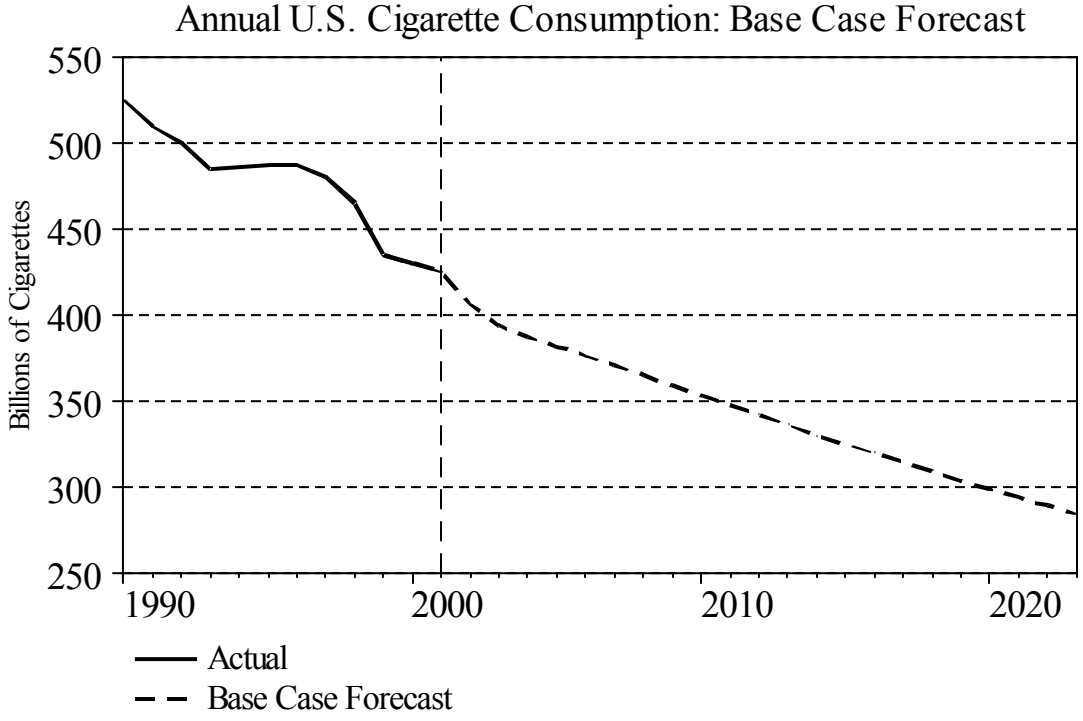
Forecast of Cigarette Consumption

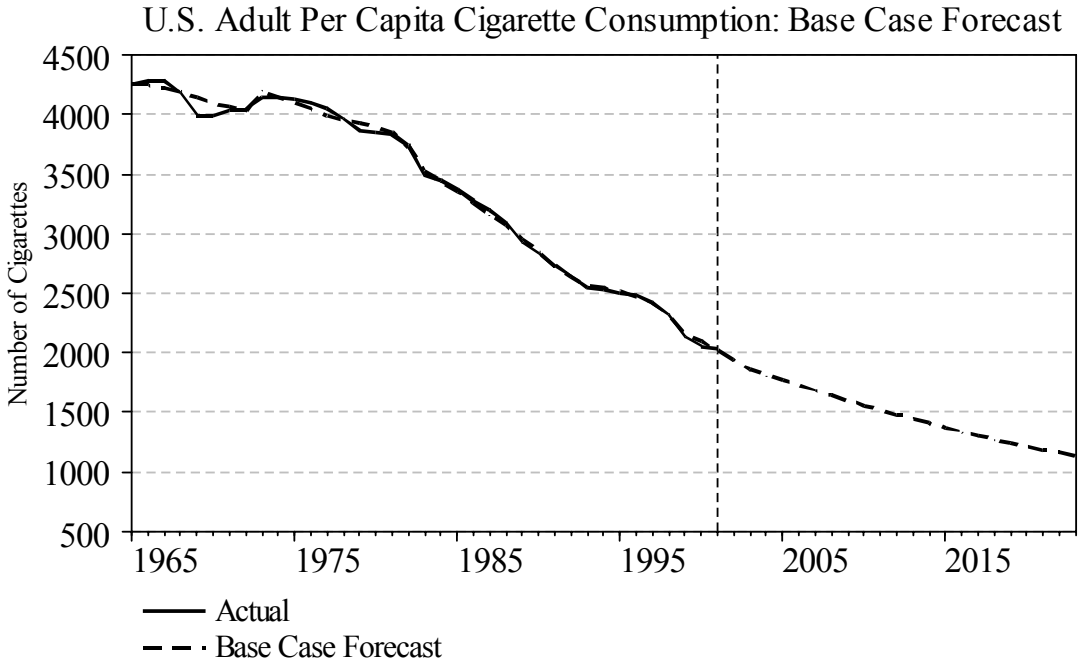
After developing the regression equation specified above, we used it to project CPC for the period 2002 through 2023. Then using the standard adult population projections of Global Insight's macroeconomic model, we converted per capita consumption to aggregate adult consumption. We then added our estimate of teenage smoking volume going forward.

In using regression equations developed on the basis of historical data to project future values of the dependent variable, we must also assume that the underlying economic structure captured in the equation will remain essentially the same. While past

performance is no guarantee of future patterns, it is still the best tool we have to make such projections.

The graphs below display the projected time trend of U.S. cigarette consumption. The first graph illustrates total actual and projected cigarette consumption in the United States. The second graph illustrates actual and projected CPC in the United States. For the period 1965 through 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. Domestic industry shipments for 2001 were, at 406.3 billion, 3.2% below 2000.

In 2002, domestic industry shipments for the year, as reported by the manufacturers, fell 3.7% below 2001, to 391.4 billion. Imports of cigarettes, however, increased significantly in 2002, as the deep discount market segment has gained market share. In 2001, imports to the U.S. were 14.7 billion cigarettes, according to the USDA. For 2002, the International Trade Administration reports that imports were 20.6 billion, a 40% increase. Through June, imports for 2003 total 11.6 billion, a 13% increase over 2002.

Shipments for 2002 exceed consumption, because inventory levels were deliberately depleted for year-end 2001 in anticipation of the January 2002 increase in the Federal Excise Tax. They were rebuilt in the first quarter of 2002 as shipments increased by 3.7 billion. Domestic shipments in the first quarter of 2003 were down sharply, by 12.9% from a year ago, to 88.2 billion. This followed a 7.4% decline in the last quarter of 2002 to 90.4 billion sticks. Last year's numbers, reflecting shipments in early 2002, were inflated however by an inventory buildup of 3 to 9 billion units. Nevertheless, it is clear that cigarette consumption fell sharply in late 2002. A significant fall was expected in the latter part of 2002 as the state excise tax increases across the country went into effect. Domestic shipments reported for the second quarter increased to 95.8 billion, 2.5% below the level a year ago, and increased further, to 96.8 billion, in the third quarter. For the year 2003 to date, shipments are down 6.7% from the first three quarters of 2002.

Cigarette consumption is estimated to have declined by 4.4% in 2002, and projected to decline by 3.2% in 2003. After 2003, the rate of decline is projected to moderate and average less than 2% per year. From 2001 through 2023 the average annual rate of decline is projected to be 1.81%. On a per capita basis consumption is projected to fall at an average rate of 2.60% per year. Total consumption of cigarettes in the U.S. is projected to fall from an estimated 425 billion in 2001 to under 400 billion in 2003, under 300 billion by 2020, and to reach 284 billion in 2023.

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 term conclusions were quite similar to this study. By the final year of the prior forecast, 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.

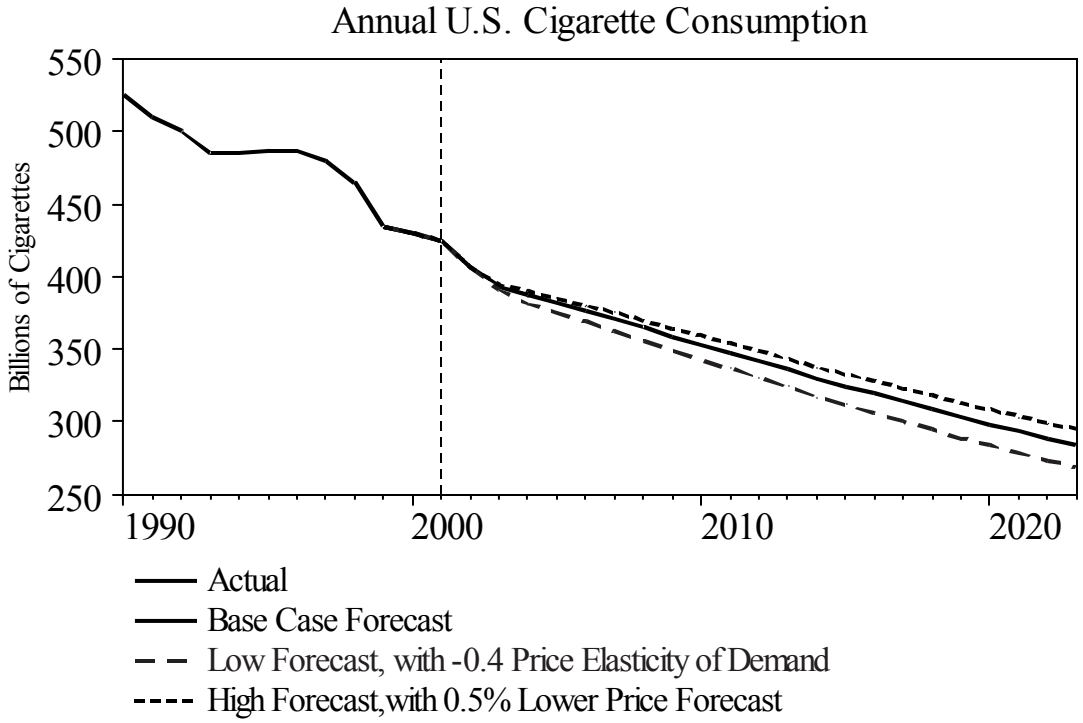
This forecast also differs somewhat from one presented to other issuers in 2002 and earlier in 2003. The recent revisions in this forecast are due to three factors. First, a larger number than originally anticipated of state excise tax increases went into effect in 2002. We have moderated our forecast to take them fully into account. Second, based on shipment reports from manufacturers and collection reports from the BATF, the historical level of shipments for 2001 and 2002 is estimated to be higher. Third, in light of the reported shipment declines in late 2002 and early 2003, we have increased our projected rate of consumption decline in 2003.

Alternative Forecasts

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

The high and low alternative forecasts are derived as follows. For the high scenario, we use a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than our current base case forecast. Under this scenario, the rate of decline is moderated slightly, from an average rate of 1.81% to 1.65%, resulting in consumption of 295 billion in 2023.

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 2.07% and results in cigarette consumption of 268 billion in 2023.



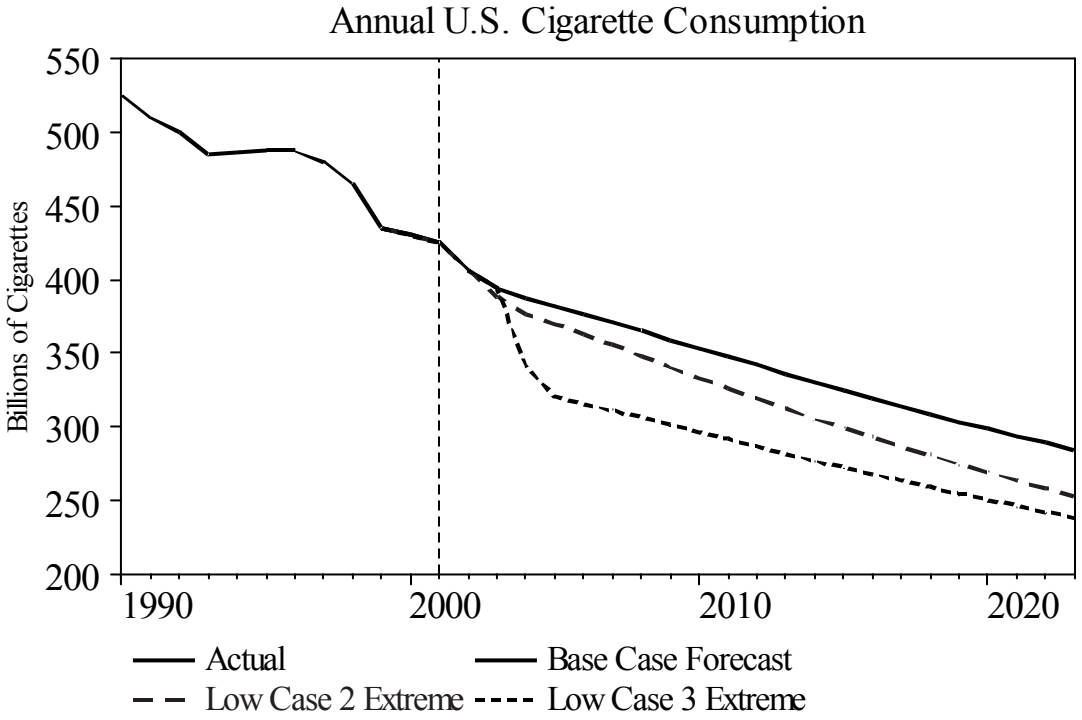
Hypothetical Stress Scenarios

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 2.33%, and results in demand of 253 billion cigarettes in 2023 (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 2.70% per year, accelerated to a pace of 4.32% annually, demand would also fall to 253 billion in 2023.

A second large negative stress is placed by postulating, in 2004, 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% over two years, in consumption. By 2023, consumption will have fallen to 238 billion cigarettes, an average annual rate of decline of 2.60% (Low Case 3). The estimated price elasticity of –0.31 is used in this case. This results in lower consumption by 2032 than in Global Insight Low Case 2.

Alternative Forecasts

	2023 Consumption Level (Bil.)	Average Annual Decline (%)
Base Case Forecast	284	1.81
Low Case 1	268	2.07
High Alternative	295	1.65
Low Case 2	253	2.33
Low Case 3	238	2.60



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 194 billion by 2023 and at 4% it falls to 173 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	4.11	7.47	1.14	0.08	5.92	3.20
2001	0.17	4.36	1.10	0.08	5.92	3.45
2002	0.36	5.76	1.02	0.08	5.91	3.71
2003	0.74	4.20	0.96	0.08	5.87	3.98
2004	2.35	1.67	0.87	0.08	5.84	4.16
2005	2.15	1.87	0.98	0.08	5.82	4.36
2006	2.32	2.59	0.89	0.08	5.80	4.58
2007	2.25	2.63	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

Historical / Base Case Forecast U.S. Adult Per Capita and Total Consumption of Cigarettes (1965 – 2023)

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
1965	4259	1.53	528.70	26.44	3.42
1966	4287	0.66	541.20	27.06	2.36
1967	4280	-0.16	549.20	27.46	1.48
1968	4186	-2.20	545.70	27.29	-0.64
1969	3993	-4.61	528.90	26.45	-3.08
1970	3985	-0.20	536.40	26.82	1.42
1971	4037	1.30	555.10	27.76	3.49
1972	4043	0.15	566.80	28.34	2.11
1973	4148	2.60	589.70	29.49	4.04
1974	4141	-0.17	599.00	29.95	1.58
1975	4123	-0.43	607.20	30.36	1.37
1976	4092	-0.75	613.50	30.68	1.04
1977	4051	-1.00	617.00	30.85	0.57
1978	3967	-2.07	616.00	30.80	-0.16
1979	3861	-2.67	621.50	31.08	0.89
1980	3849	-0.31	631.50	31.58	1.61
1981	3836	-0.34	640.00	32.00	1.35
1982	3739	-2.53	634.00	31.70	-0.94
1983	3488	-6.71	600.00	30.00	-5.36
1984	3446	-1.20	600.40	30.02	0.07
1985	3370	-2.21	594.00	29.70	-1.07
1986	3274	-2.85	583.80	29.19	-1.72
1987	3197	-2.35	575.00	28.75	-1.51
1988	3096	-3.16	562.50	28.13	-2.17
1989	2926	-5.49	540.00	27.00	-4.00
1990	2826	-3.14	525.00	26.25	-2.78
1991	2727	-3.50	510.00	25.50	-2.86
1992	2647	-2.93	500.00	25.00	-1.96
1993	2542	-3.97	485.00	24.25	-3.00
1994	2524	-0.71	486.00	24.30	0.21
1995	2505	-0.75	487.00	24.35	0.21
1996	2482	-0.84	487.00	24.35	0.00
1997	2423	-2.50	480.00	24.00	-1.44
1998	2320	-4.25	465.00	23.25	-3.13
1999	2136	-7.93	435.00	21.75	-6.45
2000	2056	-3.75	430.00	21.50	-1.15
2001	2026	-1.46	425.00	21.25	-1.16
FORECAST					
2002	1937	-4.39	406.50	20.33	-4.35
2003	1857	-4.13	393.62	19.68	-3.17
2004	1809	-2.58	386.96	19.35	-1.69

	Per Capita Consumption	Growth Rate (%)	Total Consumption (billions)	Total Consumption (billions of packs)	Growth Rate (%)
2005	1767	-2.31	381.69	19.08	-1.36
2006	1727	-2.31	376.09	18.80	-1.47
2007	1684	-2.44	370.57	18.53	-1.47
2008	1642	-2.51	365.00	18.25	-1.50
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

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	425.00	21.25	-1.16	425.00	21.25	-1.16	425.00	21.25	-1.16
2002	406.50	20.33	-4.35	406.50	20.33	-4.35	406.50	20.33	-4.35
2003	393.62	19.68	-3.17	390.95	19.55	-3.82	394.52	19.80	-2.95
2004	386.96	19.35	-1.69	381.34	19.07	-2.46	389.99	19.50	-1.15
2005	381.69	19.08	-1.36	375.48	18.77	-1.54	385.33	19.27	-1.19
2006	376.09	18.80	-1.47	369.13	18.46	-1.69	380.31	19.02	-1.30
2007	370.57	18.53	-1.47	362.80	18.14	-1.72	375.33	18.77	-1.31
2008	365.00	18.25	-1.50	356.29	17.81	-1.79	370.11	18.51	-1.39
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

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 2004		
	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	425.00	21.25	-1.16	425.00	21.25	-1.16	425.00	21.25	-1.16
2002	406.50	20.33	-4.35	406.50	20.33	-4.35	406.50	20.33	-4.35
2003	393.62	19.68	-3.17	388.14	19.41	-4.52	393.62	19.68	-3.17
2004	386.96	19.35	-1.69	376.47	18.82	-3.01	341.27	17.06	-13.30
2005	381.69	19.08	-1.36	369.90	18.49	-1.75	320.22	16.01	-6.17
2006	376.09	18.80	-1.47	362.68	18.13	-1.95	315.54	15.78	-1.46
2007	370.57	18.53	-1.47	355.44	17.77	-2.00	310.93	15.55	-1.46
2008	365.00	18.25	-1.50	348.12	17.41	-2.06	306.14	15.31	-1.54
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	-2.20	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

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	425.00	21.25	-1.16	425.00	21.25	-1.16
2002	410.13	20.51	-3.50	408.00	20.40	-4.00
2003	395.77	19.79	-3.50	391.68	19.58	-4.00
2004	381.92	19.10	-3.50	376.01	18.80	-4.00
2005	368.55	18.43	-3.50	360.97	18.05	-4.00
2006	355.65	17.78	-3.50	346.53	17.33	-4.00
2007	343.20	17.16	-3.50	332.67	16.63	-4.00
2008	331.19	16.56	-3.50	319.37	15.97	-4.00
2009	319.60	15.98	-3.50	306.59	15.33	-4.00
2010	308.41	15.42	-3.50	294.33	14.72	-4.00
2011	297.62	14.88	-3.50	282.55	14.13	-4.00
2012	287.20	14.36	-3.50	271.25	13.56	-4.00
2013	277.15	13.86	-3.50	260.40	13.02	-4.00
2014	267.45	13.37	-3.50	249.99	12.50	-4.00
2015	258.09	12.90	-3.50	239.99	12.00	-4.00
2016	249.06	12.45	-3.50	230.39	11.52	-4.00
2017	240.34	12.02	-3.50	221.17	11.06	-4.00
2018	231.93	11.60	-3.50	212.32	10.62	-4.00
2019	223.81	11.19	-3.50	203.83	10.19	-4.00
2020	215.98	10.80	-3.50	195.68	9.78	-4.00
2021	208.42	10.42	-3.50	187.85	9.39	-4.00
2022	201.12	10.06	-3.50	180.34	9.02	-4.00
2023	194.08	9.70	-3.50	173.12	8.66	-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	Global Insight 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	Global Insight 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	Global Insight
RADVPC	Real Per Capita Advertising Expenditures	1960-1997	Global Insight 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 F

CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY

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APPENDIX F

CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY

*The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the Securities and Exchange Commission (the "**SEC**"). Such reports are available on the SEC's website (www.sec.gov) and upon request from the Office of Public Reference of the SEC, 450 5th Street, NW, Room 1300, Washington, D.C. 20549-0102 (phone: (202) 942-8090; fax: (202) 628-9001; e-mail: publicinfo@sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although the Corporation has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Corporation has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. Prospective investors in the Series 2003B Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2003B Bonds is consistent with their investment objectives.*

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

MSA payments are computed based in part on cigarette shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The Global Insight Report states that the quantities of cigarettes shipped and cigarettes consumed within 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 2002 collectively accounted for approximately 92% of the domestic cigarette industry retail market share when measured by sales volume, and for approximately 92% 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 73% and 27%, respectively, measured by volume of all domestic cigarette shipments in 2002.

Philip Morris USA Inc. ("**Philip Morris**"), a subsidiary of Altria Group, Inc. ("**Altria**") is the largest tobacco company in the United States. On January 27, 2003, Philip Morris formally changed its name to Altria Group Inc. Altria's domestic and international tobacco companies will continue to be known as Philip Morris USA and Philip Morris International Inc. In its Form 10-K filed with the SEC for the year ended December 31, 2002, Altria reported that Philip Morris' domestic retail market share in 2002 was 50.1% (measured by sales volume), which represents a decrease of 0.7 share points from its self-reported 2001 domestic retail market share based on sales of 50.8%. In its Form 8-K filed with the SEC on October 16, 2003, Altria reported that, for the three-month period ended September 30, 2003, Philip Morris' domestic retail market share based on shipments was 48.8%. Due to a change in its retail tracking service, Philip Morris is not reporting retail market share comparisons to its 2002

figures. Philip Morris's major premium brands are Marlboro, Virginia Slims, Benson & Hedges, Merit and Parliament. Its principal discount brands are Basic and Cambridge. Marlboro is the largest selling cigarette brand in the United States, with approximately 37.9% of the United States domestic retail share in 2002, and has been the world's largest-selling cigarette brand since 1972.

R. J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), a wholly owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc. ("**RJR**") is the second largest tobacco company in the United States. On January 16, 2002, Reynolds Tobacco acquired Santa Fe Natural Tobacco Company, Inc. In its Form 10-K filed with the SEC for the year ended December 31, 2002, RJR reported that Reynolds Tobacco's domestic retail market share in 2002 was 22.93% (measured by sales volume), which represents a decrease of 0.49 share points from its self-reported 2001 domestic retail market share. In its Form 10-Q filed with the SEC for the three-month period ended September 30, 2003, RJR reported that Reynolds Tobacco's domestic retail market share averaged 22.4%, a decrease of .8 share points when compared with the third quarter of 2002. Reynolds Tobacco's major premium brands are Winston, Camel, Salem, Vantage, More and Now. Its discount brands include Doral, Monarch and Best Value.

Brown & Williamson Tobacco Corporation ("**B&W**") is a wholly-owned subsidiary of British American Tobacco, p.l.c., a holding company based in London, England. B&W 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 2002 was 10.32%, which represents a decrease of .07 share points from its self-reported 2001 domestic retail market share. Its domestic retail market share based on sales for the three months ended June 30, 2003 is 10.6%. B&W's largest selling brand is GPC, a discount brand. Its other major brands are Pall Mall Filtered, Misty, Capri, Advance and Lucky Strike.

On October 27, 2003, R.J. Reynolds Tobacco Holdings, Inc. ("**RJR Holdings**") and British American Tobacco p.l.c. ("**BAT**") announced the signing of a definitive agreement to combine the assets and operations of their respective U.S. tobacco businesses, Reynolds Tobacco and B&W. In its Form 10-Q filed with the SEC for the three-month period ended September 30, 2003, RJR stated that the agreement provides for establishing a new publicly traded holding company, Reynolds American Inc. ("**Reynolds American**"). Upon completion of the combination, B&W will own 42% of Reynolds American and RJR shareholders will own 58% of Reynolds American. The agreement provides for B&W to transfer with its U.S. operations cash in an amount equal to accrued MSA expenses. The cash balance is contingent on the timing of the transaction, but averages approximately $750 million during the year. The Reynolds Tobacco and B&W tobacco operations will be combined in an indirect subsidiary of Reynolds American, and that subsidiary will indemnify B&W for its historical and current litigation liabilities. The transaction is expected to close in the first half of 2004, pending the necessary clearances from U.S. and European regulatory authorities and RJR stockholders, as well as satisfactory IRS rulings.

Lorillard Tobacco Company ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation ("**Loews**"), is the fourth largest tobacco company in the United States. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. In its Form 10-K filed with the SEC for the year ended December 31, 2002, Loews reported that Lorillard's domestic retail market share in 2002 was 9.05% (measured by shipment volume), which represents a decrease of 0.45 share points from its self-reported 2001 domestic retail market share. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2003, Loews reported that Lorillard's domestic retail market share based on shipments was 9.29%, an increase of .11 share points from the first nine months of 2002. Lorillard's major brands are Newport, Kent, True, Maverick and Old Gold. Its largest selling brand is Newport, which accounted for approximately 88% of Lorillard's sales in 2002.

Based on the domestic retail market shares discussed above, the remaining share of the United States retail cigarette market in 2002 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fifth largest tobacco company in the United States. In its Form 10-K filed with the SEC for the year ended December 31, 2002, Vector reported that Liggett's domestic retail market share in 2002 was 2.5% (measured by shipment volume), which represents an increase of 0.3 share points over its 2001 domestic retail market share. Liggett currently produces two premium brands: Eve 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 announced that it has introduced three varieties of a low nicotine cigarette in seven states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Liggett and Vector are SPMs under the MSA.

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 retail sales.

Manufacturers' Domestic Retail Market Share Based on Sales*

Manufacturer	1998	1999	2000	2001	2002
Philip Morris	49.4%	49.9%	50.5%	50.8%	50.1%
Reynolds Tobacco	25.2	23.9	23.6	23.4	22.9
B&W/American Brands	15.0	13.4	11.7	10.4	10.3
Lorillard	9.3	10.6	9.6	9.3	9.1
Other†	1.1	2.2	4.6	6.1	7.6

* 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 from 100%.

Shipment Trends

The following table depicts 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 Retail Market Share Based on Shipments*

Manufacturer	1998	1999	2000	2001	2002
Philip Morris	49.4%	49.6%	50.5%	51.0%	48.9%
Reynolds Tobacco	24.0	23.0	23.0	22.3	23.1
B&W/American Brands	15.0	13.4	11.7	10.9	11.2
Lorillard	9.3	10.6	9.8	9.5	9.1
Other†	2.3	3.4	5.0	6.3	7.7

* The shipment market shares of each of the OPMs have been obtained from the publicly available documents of the OPMs.

† The retail market share of tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in the publicly available documents 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, 2002. The MSA payments are calculated in part on industry shipments rather than consumption.

Year Ended December 31,	Domestic Shipments (Billions of Cigarettes)*
1998	460.8
1999	419.3
2000	419.8
2001	406.3
2002	391.4

* As reported in SEC filings of the OPMs.

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

Additionally, as reported by Management Science Associates, Inc., industry volume shipments declined by 12.9% in the first quarter of 2003 from the comparable period in 2002. This decline reflects some trade inventory buildups versus the same period in 2002, and is not likely to be indicative of full-year volume shipments for 2003. However, it also reflects recent state excise tax increases, increases in awareness regarding the health risks associated with smoking, legislative restrictions on smoking in public, and the generally lower social acceptability of smoking. See "Consumption Trends", "Tax Collections" and "Regulatory Issues" below.

Consumption Trends

According to an October 2003 estimate of the United States Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the United States consumed an estimated 420 billion cigarettes in 2002, 1.2% less than a year earlier. Annual per capita consumption (per adult over 18) has dropped from 2,543 cigarettes in 1993 to an estimated 1,903 in 2003. U.S. cigarette output in 2003 is expected to decline about six percent from 2002, due in part to a decline in consumption. Annual per capita consumption in 2003 is projected at 410 million pieces, 2.0% less than 2002. The following chart sets forth domestic cigarette consumption from 1998 through 2002.

Year Ended December 31,	US Domestic Consumption (Billions of Cigarettes)*
1998	465
1999	435
2000	430
2001	425
2002	415†

* USDA-ERS. The MSA payments are calculated in part on domestic industry shipments rather than consumption. The Global Insight Report states that the quantities of cigarettes shipped and cigarettes consumed within 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 by USDA-ERS.

Tax Collections

In Fiscal Year 2001 (October 2000 to September 2001), federal cigarette excise tax collections totaled approximately $7.4 billion. In January 2002, the federal excise tax was raised by $0.05 per pack to $0.39 per pack. At the state level, sales taxes on cigarettes and excise taxes have over recent years increased significantly. Currently, nineteen states have cigarette excise taxes of $0.50 per pack or greater and five have taxes of $1.00 or greater. State taxes range from $0.025 per pack in Virginia to $1.51 per pack in Massachusetts. New York State has a State tax of $1.50 per pack, with an additional tax of $1.50 per pack in New York City. In addition, the USDA-ERS reports that by the end of 2003, 14 states will increase cigarette taxes. Increases in state taxes will increase the average price per pack to approximately $4.00.

Distribution and Competition

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. Substantial marketing support, merchandising display and competitive pricing generally are required to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in increased competitive discounting and the proliferation of discounts and 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 or billboard advertising of cigarettes has been prohibited in the United States. The domestic tobacco manufacturers have agreed to marketing restrictions in the United States as part of the MSA and the other settlement agreements. They are still permitted, however, to conduct advertising campaigns in magazines, at retail cigarette locations, in direct mail campaigns targeted at adult smokers, and in other adult media.

Grey Market

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, grey market imports were estimated at 3 billion to 4.5 billion pieces, less than 1 percent of total consumption. Legislation prohibiting grey market sales became effective in January 2000. According to USDA-ERS, grey market sales are expected to cease. In addition, one OPM reports that it has taken legal action against certain distributors and retailers who engage in such practices.

Recent Rating Agency Actions

In 2003, the Rating Agencies have downgraded the ratings of certain tobacco product manufacturers and the ratings of outstanding bonds secured solely by payments to be made by under the MSA. The Rating Agencies have stated that their actions reflect weakening U.S. cigarette industry conditions (including the adverse litigation environment, including the recent *Price* decision and its associated bonding requirement, and the possibility of greater litigation risk in the future), expected state excise tax increases, expectations for further pressure on industry shipment volume (as evidenced by first quarter 2003 industry shipment declines which exceeded prior volume assumptions), and future pricing uncertainties. The Rating Agencies have stated that all of these factors could contribute to a weakened cash flow supporting tobacco securitization bonds. On March 24, 2003, the first business day following the *Price* decision, Moody's placed its ratings of Altria Group, Inc., the parent of Philip Morris, under review for possible downgrade, S&P placed its ratings of Altria Group, Inc., on Credit Watch with negative implications, and Fitch placed its ratings of Altria Group, Inc., on Rating Watch Negative. On March 26, 2003, Fitch placed all of its ratings on tobacco settlement securitizations on Rating Watch Negative, and S&P placed all of its ratings on tobacco settlement securitizations on CreditWatch with negative implications. On March 27, 2003, Moody's announced it would review its ratings on tobacco settlement securitizations for possible downgrade. On March 31, 2003, Moody's downgraded the long and short-term ratings of Altria Group, Inc. and maintained these ratings under review for possible further downgrade. In addition, Moody's downgraded its ratings on tobacco settlement securitizations (from "A1" to "A3"). On April 3, 2003, Fitch downgraded its ratings on tobacco settlement securitizations (from "A+" to "A-"). On April 9, 2003, S&P lowered its long-term corporate credit rating on Altria Group, Inc. to "BBB+" and left it on Credit Watch Negative. On April 14, 2003, S&P placed Loews Corporation on Credit Watch Negative. On April 15, 2003, Moody's changed Loews Corporation's outlook to negative. On April 16, 2003, Fitch downgraded its long term rating on Loews Corporation (from "A+" to "A"). On April 18, 2003, S&P downgraded its ratings on tobacco settlement securitizations (from "A" to "A-"). On April 22, 2003, Moody's downgraded Altria Group, Inc. to "Baa2" with a negative outlook. On May 6, 2003, Fitch downgraded the ratings of Altria Group, Inc. and R.J. Reynolds Tobacco Holdings, Inc. ("**Reynolds Holdings**") to "BBB" and "BB+", respectively. In addition, Fitch downgraded its ratings on tobacco settlement securitizations (from "A-" to "BBB"). Reynolds Holdings remains on Rating Watch Negative. In May 2003, the ratings of British American Tobacco Plc ("**B&W**") were downgraded (to "Baal" by Moody's and "A-" by S&P) with a negative outlook by each of Fitch, Moody's and S&P. On June 2, 2003, Moody's downgraded its ratings on virtually all tobacco settlement securitizations (from "A3" to "Baa1" for Bonds maturing in or before 2008 and "Baa2" for Bonds maturing thereafter). On June 10, 2003, S&P downgraded its corporate rating on Loews Corporation (from "A+" to "A") and removed Loews Corporation ratings from Credit Watch. On June 16, 2003, Moody's downgraded its ratings of Reynolds Holdings' senior guaranteed unsecured indebtedness and senior unguaranteed unsecured indebtedness to "Ba1" and "Ba2", respectively, and kept each rating under review for possible future downgrade. On July 1, 2003, S&P downgraded its rating of Reynolds Holdings' senior unsecured debt to "BB+". On July 15, 2003, Fitch again placed all of its ratings on tobacco settlement securitization on Rating Watch Negative. On July

17, 2003 Moody's placed its ratings on B&W on review for possible downgrade, and S&P placed its long term rating of B&W ("A-") on Watch Negative. On July 18, 2003, Fitch downgraded its long term rating on B&W (from "A" to "A-"). On August 12, 2003, S&P revised its outlook on Reynolds Holdings to negative. On August 22, 2003, S&P cut its rating on B&W (from "A-" to "BBB+"). On August 27, 2003 Fitch downgraded its long term rating for Loews Corporation (from "A" to "A-"). On August 28, 2003, S&P further downgraded its ratings on virtually all tobacco settlement securitizations (from "A-" to "BBB"). S&P also has all tobacco settlement securitization bond ratings on Creditwatch Negative for possible future downgrades. On September 18, 2003, S&P reaffirmed its "BBB" rating of Altria Group, Inc. and removed it from Credit Watch. On September 19, 2003, Fitch affirmed its "BBB" rating of Altria Group, Inc. and removed it from Rating Watch Negative. On October 28, 2003, Moody'affirmed the rating of Reynolds Holdings and changed its outlook from negative to stable. On October 28, 2003, Fitch Ratings affirmed its long term rating on Reynolds Holdings, Inc. ("BB") and removed Reynolds Holdings from Rating Watch Negative. There can be no assurance that any ratings assigned to the tobacco settlement securitizations or the tobacco product manufacturers will continue for any given period of time or that such ratings will not be further revised, suspended or withdrawn entirely by the Rating Agencies.

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**"). Such legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. 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.

On August 9, 2000, the United States Surgeon General issued a report, "Reducing Tobacco Use: A Report of the Surgeon General," which assessed the value and efficacy of the approaches (educational, clinical, regulatory, economic and comprehensive) that have been used to reduce tobacco use, and evaluated the scientific evidence for each approach. The report stated that widespread dissemination of approaches and methods which have been shown to be effective, especially in combination, would, among other things, substantially reduce the number of young people who will become addicted to tobacco, increase the success rate of young people and adults trying to quit using tobacco, and reduce the level of exposure of non-smokers to environmental tobacco smoke. The report concluded that substantial increases in the 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 report cited as examples the 75 cents per pack proposal contained in the Clinton administration's Health Security Act of 1993 (which did not pass) and the proposal contained in *Healthy People 2010,* the national action plan prepared by the United States Department of Health and Human Services to improve the health of all people living in the United States in the first decade of the 21st century, which set as a goal an average state and federal excise tax of $2.00. The report's conclusions are not formal policy recommendations, but are intended as a summary of the scientific literature concerning successful methods of reducing tobacco consumption.

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 cannot

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 under-age 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 which asserts that there is sufficient evidence to conclude that ETS causes cancer in humans. Certain of the PMs 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 appealed to the United States Court of Appeals for the Fourth Circuit. On December 11, 2002, the Fourth Circuit dismissed the challenge, holding that the EPA's report is advisory and does not constitute a final agency action that can be reviewed by courts. The court stayed its decision for 30 days, to allow the plaintiffs time to appeal to the U.S. Supreme Court. Philip Morris has announced that it will not appeal.

In 1994, the United States Occupational Safety and Health Administration ("**OSHA**") announced proposed regulations that would restrict smoking in the workplace to designated smoking areas that have separate exhaust systems, but no such regulations have been adopted to date. 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, but claimed that 70 percent of employees now work where smoke-free workplace policies exist.

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. For example, on June 14, 2002, Senators Kennedy, DeWine and others introduced legislation to provide the FDA with certain authority to regulate tobacco products and to recognize the FDA as the primary federal regulatory authority with respect to the manufacture, marketing and distribution of tobacco products. All of the pending legislation could result in substantial federal regulation of the design, performance, manufacture and marketing of cigarettes. At least one tobacco company has stated that, while it continues to oppose FDA regulation of cigarettes as "drugs" or "medical devices," it would support new legislation that would provide for reasonable regulation by the FDA of cigarettes as cigarettes. 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. Two Congressional committees held hearings during the summer of 2003 regarding legislation to give the FDA the authority to regulate tobacco products, but the proposed measure was unsuccessful. It has been reported that Philip Morris is supportive of the hearings and of some form of regulation. No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes.

Federal law prohibits smoking on all scheduled passenger aircraft. In addition, the United States Interstate Commerce Commission has banned smoking on buses transporting passengers interstate.

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. Most recently, on February 12, 2003, the Interagency Committee on Smoking and Health, which reports to the U.S. Department of Health and Human Services, issued recommendations which include raising the federal excise tax on cigarettes from $0.39 to $2.39 per pack. The purpose of the tax increase would be to discourage smoking and to fund anti-tobacco efforts. According to the Global Insight Report, Health and Human Services Secretary Thompson has indicated that the Bush administration is not contemplating the tax increase.

State and Local Regulation. In addition to federal regulation, most of the states and many local jurisdictions have enacted or are considering 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 Global Insight Report, at least thirty states had considered increases in excise taxes on cigarettes as a response to budget shortfalls following the 2001 recession, and excise tax increases have been enacted this year in Arkansas, Connecticut, Delaware, Georgia, Idaho, Montana, Nevada, New Jersey, New Mexico, Rhode Island, South Dakota, West Virginia and Wyoming. 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.

For example, Massachusetts has enacted legislation to require cigarette manufacturers to report the flavorings and other ingredients used in each brand of cigarettes sold in Massachusetts and on a qualified, by-brand basis, to provide "nicotine-yield ratings" for their products based on standards established by Massachusetts. 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, in *Philip Morris v. Reilly,* the federal district court granted the plaintiffs' 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 Commonwealth and finding that it did not constitute an impermissible taking of property. 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. In December 2002, the First Circuit, sitting *en banc,* struck down the legislation.

In August 2000, legislation was adopted in the State which requires cigarettes sold in the state to be "fire safe" or "self-extinguishing" beginning in 2003. The New York Department of State set November 3, 2003 as the final date to receive comments on the regulations, and it expects the final regulations to be issued by the end of December. Six months after issuance, all cigarettes for sale in the State will have to be self-extinguishing. Similar legislation has been proposed (but not adopted) in other states and localities, at the federal level and in foreign jurisdictions. Another statute, which was enacted in the State in 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 banned mail order, Internet and telephone cigarette sales directly to consumers in the state. In a suit filed by one OPM and one SPM, which alleged that the statute was an unconstitutional interference with commerce, a federal district court invalidated the statute prior to its effective date and permanently enjoined its enforcement. The United States Court of Appeals for the Second Circuit has reversed the district court's ruling and the statute became effective May 5, 2003. Two subsequent suits have been filed challenging the statute.

In New York City, the Smokefree Air Act of 2002, which banned smoking in most of the City's bars and restaurants, became effective on March 30, 2003.

According to the Global Insight Report, all fifty states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. On September 1, 2003, Alabama became the fiftieth state to require smoke-free indoor air in certain public places. As of October 1, 2003, there were 1,641 municipalities with indoor smoking restrictions. In March 2003, the New York State Legislature passed, and the governor signed, legislation banning smoking in indoor workplaces, including restaurants and bars. Delaware had banned smoking in any indoor public areas in 2003. These states join California in imposing comprehensive statewide smoking bans. The California ban has been in place since 1998. The states of Connecticut and Maine recently adopted legislation which will ban smoking in restaurants and in bars. The state of Florida also, as a result of a referendum in 2002, established a smoking ban, though it exempts certain bars. Similarly comprehensive bans took effect in New York City and Dallas in March 2003 and in Boston in May 2003. The city of Chicago is also considering these measures. A few smaller cities, including Lexington, Kentucky, have also instituted smoking bans in 2003.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control, aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. In May 2003, after expressing initial concerns over potential constitutional and statutory problems of individual countries, United States officials expressed some support for the treaty, which was adopted during the World Health Organization's health assembly on May 21, 2003. In order for the treaty to take effect, forty countries must ratify it.

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

Civil Litigation

The tobacco industry has been the target of litigation for many years. In the United States, both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from ETS, also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating in the billions of dollars. The MSA does not release PMs from liability in either individual or class action cases. Health care cost recovery cases have also been brought by governmental and non-governmental health care providers seeking, among other things, reimbursement for health care 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 health care cost recovery claims by the Settling States. Litigation has also been brought against certain PMs and/or their affiliates in foreign countries. 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, which include its settlement of *Broin I,* the lawsuits filed by the Previously Settled States, and lawsuits filed by the Settling States which were settled by the MSA and others.

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins, (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and

various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act.

According to Loews, since January 1, 2001 and through November 1, 2003, jury verdicts have been returned in 24 smoking and health cases and health care cost recovery cases. Verdicts in favor of the tobacco industry defendants were returned in sixteen of these cases. Verdicts in favor of plaintiffs were returned in twelve cases. Appeals or post-trial motions by defendants and by plaintiffs are pending in many of these cases.

Class Action Lawsuits. The MSA does not release the PMs from liability in smoking and health class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking and fraud. 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. In addition, as set forth elsewhere herein, other class action plaintiffs allege price-fixing, consumer fraud or violations of consumer protection or unfair trade statutes. One OPM reports that class certification has been denied or reversed in 29 smoking and health class actions.

Loews has reported that as of November 1, 2003, there were approximately 40 class action lawsuits pending against cigarette manufacturers as purported class actions in the United States, compared with approximately 45 such cases on December 31, 2001. Plaintiffs have historically had little 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. All but one of the federal courts which have considered the issue to date (including two federal courts of appeals) have denied or overturned class certification in smoking and health cases. By way of example only, and not as an exclusive or complete list, the following matters are illustrative of class action cases. 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 class decertification by the Third Circuit in *Barnes v. American Tobacco Company, Inc.* (formerly cited as *Arch v. American Tobacco Company, Inc.*). On March 19, 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 by, 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 10 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 health care 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. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consists of all smokers who have been diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease between April 9, 1993 and a future time when the class is to be notified of the certification. The defendants have sought

reconsideration by the trial judge and, on October 3, 2002, asked the U.S. Court of Appeals for the Second Circuit to review the certification decision. In February 2003, the Second Circuit granted the petition. 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.* The parties agreed to dismiss the case in March 2001. In September 2000, in *Walls v. American Tobacco Co.,* an Oklahoma state court answered a series of state law questions, certified to the state court by the federal court where the purported class was filed, in such a way that led the parties to stipulate that the case should not be certified as a class action in federal court and that the individual plaintiffs would dismiss their federal court cases without prejudice. In October 2000, the federal court issued its order refusing to certify the case as a class action, and dismissed the individual plaintiffs' cases. In 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.* (also known as the *Apostolou* case), the Appellate Division of the Supreme Court of New York 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 most 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. In December 2000, in *Geiger v. American Tobacco Co.,* the Appellate Division of the Supreme Court of New York affirmed the trial court's denial of class action status to a purported class defined as all New York residents, including their heirs, representatives and estates, who contracted lung and/or throat cancer as a result of smoking cigarettes. Plaintiffs filed a motion for leave to appeal the order denying certification to the New York Court of Appeals, the highest court in the state. The New York Court of Appeals dismissed plaintiff's appeal in February 2001.

In 1996, in *Engle v. Reynolds Tobacco, et al*., a Florida state trial court certified a class consisting of all Florida residents and citizens, and their survivors, "who have suffered, presently suffer or have died from diseases and medical conditions caused by their addiction to cigarettes that contain nicotine." In July 1999, in Phase I of a three-phase trial, the jury returned a verdict against defendants concerning certain issues determined by the trial court to be "common" to the causes of action of the plaintiff class. Among other things, the jury found that smoking cigarettes causes 20 diseases or medical conditions, that cigarettes are addictive or dependence-producing, defective and unreasonably dangerous, that defendants made materially false statements with the intention of misleading smokers, that defendants concealed or omitted material information concerning the health effects and/or the addictive nature of smoking cigarettes, and that defendants were negligent and engaged in extreme and outrageous conduct or acted with reckless disregard with the intent to inflict emotional distress. In Phase II, the jury determined that the three individual class representatives were entitled to compensatory damages in varying amounts which were offset by their comparative fault. The total award was $12.7 million. Thereafter, the jury determined the lump-sum amount of punitive damages for the entire class to be $145 billion, without allocation of that amount to any class member. The punitive damages awarded against the OPM defendants: Philip Morris, $74 billion; Reynolds Tobacco, $36 billion; B&W, $18 billion; Lorillard, $16 billion; and Liggett, $790 million.

The defendants filed several post-verdict motions, and in November 2000, without a hearing, the trial court denied the defendants' post-trial motions and entered judgment on the compensatory and punitive damages awarded by the jury. In accordance with Florida law enacted in May 2000 limiting the size of the bond that must be posted in order to stay execution of a judgment for punitive damages in a certified class action to no more than $100 million, regardless of the amount of punitive damages ("**bond cap legislation**"), Philip Morris and the other defendants posted their appeal bonds with their appeal filing. In addition, as plaintiffs had previously indicated that they might seek to challenge the bond cap legislation as unconstitutional, and as certain OPMs indicated that if a court were to declare such legislation invalid, it would be commercially impossible to post a bond in the full amount of the judgment, Philip Morris, Lorillard, Liggett (the "**Stipulating Defendants**"), and the plaintiffs entered into a stipulation (the "**Stipulation**"). The Stipulation provided that the execution of the punitive damages component would remain stayed against the Stipulating Defendants through the completion of all judicial review, regardless of any challenge to the bond cap legislation. Under the Stipulation, Philip Morris placed $1.2 billion into an interest-bearing escrow account, which would be returned to Philip Morris if it ultimately prevailed after completion of review. The Stipulation defines "completion of review" as the completion of all judicial review of the judgment in the Third District Court of Appeal of Florida, the Florida Supreme Court and the United States Supreme Court, such

judgment is no longer subject to any further consideration or review in any such court. 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**"), which, even if the Stipulating Defendants were to prevail, would be paid to the court and distributed in a manner consistent with the Florida Rules of Civil Procedure.

On May 21, 2003, Florida's Third District Court of Appeal reversed the final judgment of the trial court and remanded the case with instructions to decertify the plaintiff class, reasoning that, among other things, each class member had unique and different experiences that would require the litigation of substantially separate issues, and which were too diverse to be combined into a single claim. In July 2003, the plaintiffs moved for re-consideration. On September 22, 2003, the appellate court denied that request. The defendants will not be able to recoup the refundable portion of their appeal bonds until all appeals are exhausted.

To date, in addition to Florida's bond cap legislation, other states have also enacted appeal bond legislation: Georgia, Indiana, Kentucky, Louisiana, Michigan, Nevada, North Carolina, Ohio, Oklahoma, South Carolina, Virginia and West Virginia. In Mississippi, the Mississippi Supreme Court has imposed appeal bond limits by court rule.

One *Engle* class member had already gone to trial. In *Lukacs v. Reynolds Tobacco,* a Florida appellate court granted plaintiff 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. Defendants have filed post-trial motions challenging the verdict. On April 1, 2003, the Dade County Circuit Court reduced the jury's award for loss of consortium from $12.5 million to $125,000. After the decertification of the *Engle* class, the status of the *Lukacs* verdict is unclear. In July 2003, the plaintiff in *Lukacs* requested Florida's Third District Court of Appeals, with regard to the Engle case, to reinstate the class for the limited purpose of letting the jury's findings that the defendants deceived the public about the dangers of smoking in the first phase of the three part class action trial stand. 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.

As of August 1, 2003, one OPM reported there were 20 putative or certified class actions pending against it on behalf of individuals who purchased and consumed various brands of cigarettes which allege, among other things, that the use of the terms "Lights" and/or "Ultra Lights" constitutes deceptive and unfair trade practices, and seek injunctive and equitable relief, including restitution. Classes have been certified in Illinois, Massachusetts and Florida, and defendants have appealed the certification orders in the cases pending in Massachusetts and Florida. The class which was certified in Massachusetts was decertified in May 2003, although the plaintiffs have appealed the decertification. In addition, in *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris Cos., Inc.*), a Madison County, Illinois state court judge certified a class comprising all residents of Illinois who purchased and consumed Cambridge Lights and Marlboro Lights within a specified time period but who do not have a claim for personal injury resulting from the purchase or consumption of the cigarettes. The plaintiffs in that case alleged consumer fraud claims and sought economic damages in the form of a refund of purchase costs of the cigarettes. On March 21, 2003, after a non-jury trial, the trial court judge ruled in favor of the plaintiffs, rendering a verdict against Philip Morris in the amount of $7.1 billion in compensatory damages, $3.0 billion in punitive damages to be paid to the state of Illinois, and $1.78 billion in attorneys' fees, and set the amount of the appeal bond required to stay judgment during appeal at $12 billion. The court also stayed execution of the judgment for 30 days. In filings with the SEC dated March 27, 2003, Philip Morris stated that it believed that filing a bond in such an amount, in order to stay execution of a judgment pending appeal, would be unconstitutional and would violate Illinois law. Philip Morris also stated that it would not be possible for it to post a bond in such an amount and, absent judicial or legislative relief, it would not be possible to stay enforcement of the judgment. Also, in an April 4, 2003 press release, a Philip Morris representative stated that there was a risk that immediate enforcement of the judgment would force a bankruptcy. On April 8, 2003, a Circuit Court judge in Cook County, Illinois placed a temporary stay on collection of the punitive damages portion of the award. On April 14, 2003, the Madison County court reduced the bond that Philip Morris must provide and stayed enforcement of the judgment pending completion of appellate review. On April 15, 2003, Philip Morris made its April 2003 MSA Annual Payment. Under the judge's order, Philip Morris would transfer possession of a pre-existing 7.0%, $6 billion long-term note from Altria to Philip Morris to an escrow account. In addition, Philip Morris would make cash deposits with the court clerk in the

flowing amounts: beginning October 1, 2003, an amount equal to the interest earned by Philip Morris on the Altria note (presently, $210 million every six months), an additional $800 million in four quarterly installments between September 2003 and June 2004 and the payments of principal of the note, which are due on April 2008, 2009 and 2010. If Philip Morris prevails on appeal, the escrowed note and all cash deposited with the court would be returned to Philip Morris with accrued interest, less administrative fees. Plaintiffs appealed the judge's order reducing the bond, after which Philip Morris asked the Illinois Supreme Court to eliminate any intermediate appellate review and hear its appeal of the judgment directly. On June 11, 2003, the Illinois Supreme Court declined to accept Philip Morris' direct appeal. Philip Morris then proceeded with its intermediate appeal to the Illinois Court of Appeals for the Fifth District, which ruled that the trial court did not have the authority to reduce the amount of the appeal bond, and remanded the case back to the trial court for reconsideration. On July 18, 2003, Philip Morris requested that the Illinois Supreme Court halt any action by the trial court to change the terms of the bond it had set and reaffirm the trial court's discretion that the reduced bond is adequate to protect the financial interests of both the plaintiffs and Philip Morris. On August 15, 2003, the trial court reinstated its original $12 billion bond requirement and granted Philip Morris 60 days within which to post the required bond. Philip Morris has moved to stay the trial court's order while its appeal to the Illinois Supreme Court remains pending. On September 16, 2003, the Illinois Supreme Court agreed to hear Philip Morris' appeal in the *Price* case. Also on that date, the Supreme Court reinstated the reduced bond amount pending the appeal. The Illinois Supreme Court has established December 3, 2003 as the deadline for Philip Morris' appeal brief. Plaintiffs' appeal brief is due not later than 35 days following the filing deadline for Philip Morris' appeal brief, and Philip Morris' reply brief is due not later than 14 days following the filing deadline for the plaintiff's appeal brief. These deadlines may be subject to modification on motion of the parties. In light of the *Price* case and other litigation, several ratings agencies have downgraded the ratings of Philip Morris' parent, Altria Group, Inc., and the ratings on tobacco settlement securitizations. See "Recent Rating Agency Actions" above.

Madison County, Illinois courts have certified similar cases in *Turner v. R.J. Reynolds Tobacco Co.* and *Howard v. Brown and Williamson*. In *Turner*, for example, the state court judge certified a class defined as "[a]ll persons who purchased defendants' Doral Lights, Winston Lights, Salem Lights and Camel Lights, in Illinois, for personal consumption, between the first date that defendants sold Doral Lights, Winston Lights, Salem Lights and Camel Lights through the date the court certifies this suit as a class action…." Trial was scheduled for October 2003. Reynolds Tobacco has reported that in the event it loses the *Turner* case, it could face bonding difficulties similar to those Philip Morris faced in the *Price* case, depending on the amount of damages ordered, if any. In *Turner*, Reynolds Tobacco has requested a stay in light of the appeal filed by Philip Morris in the *Price* case. In July 2003, the trial judge denied that request and Reynolds Tobacco has appealed to the Illinois Court of Appeals for the Fifth District. Reynolds Tobacco reports that on October 24, 2003, the Illinois Supreme Court granted an emergency stay of 90 days pending a determination of Reynolds' request for a change of venue. On November 6, 2003, the Illinois Supreme Court stayed the *Turner* case pending its ruling on the *Price* case. Reynolds Tobacco has also reported that similar classes are seeking certification in Minnesota, Missouri and Florida state court actions. In June 2003, the Court in *Howard* granted a stay until further order of the Court in light of the *Price* appeal, which involves many of the same issues. In addition, On May 7, 2003, in *Arnold v. Philip Morris*, an additional class action suit was been filed against Philip Morris for a similar class of smokers of other Philip Morris lights brands. In addition, it has been reported that in September 2003, a Medina County, Ohio judge granted class certification in another "Lights" case.

It has been reported that in *Aspinall et al. v. Philip Morris Companies and Philip Morris, Inc.* a Massachusetts state court judge had certified a class in a case involving Light/Ultra Light cigarettes. On May 27, 2003, a Massachusetts Appeals Court decertified the class. In February 2002, in *Hines v. Philip Morris,* a Florida state court certified a class action, whereby plaintiffs allege consumer fraud claims and seek economic damages in the form of a refund of purchase costs of the cigarettes or to disgorge Philip Morris of all profits it has made on Marlboro Lights.

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.

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. In October 2001, without ruling on the merits of the appeal, the appellate court dismissed defendants' appeal of the trial court's ruling on the basis that the appeal was premature and that the court lacked jurisdiction. In addition, the court of appeals has denied defendants' motion for rehearing and for rehearing *en banc,* and for certification of the October 2001 ruling to the Florida Supreme Court. In addition, in July 2002, the Florida Supreme Court denied defendants' motion to review the rulings of the trial court and the court of appeals. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. The Florida Supreme Court denied the appeal. Defendants may seek redress, according to one OPM. 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. In October 2001, the trial court denied the plaintiff's post-trial motions. The plaintiff filed an appeal, and the defendants filed a cross-appeal but the plaintiff voluntarily dismissed her appeal, rendering the defendant's cross-appeal moot. In addition, on September 5, 2002, in *Janoff v. Philip Morris,* a jury returned a verdict for the defendants in another *Broin II* case. On January 8, 2003, the court granted plaintiff's motion for a new trial, and on February 3, 2003, defendants appealed the court's ruling. On June 18, 2002, the jury in *French v. Philip Morris* awarded the plaintiff $5.5 million dollars, finding that the flight attendant's sinus disease was caused by ETS. On September 13, 2002, the court reduced the award to $500,000. The plaintiff and defendants have appealed. On October 4, 2002, in *Tucker v. Philip Morris,* a Florida state court jury found in favor of the defendants. In April 2003, the plaintiffs' motion for a new trial was denied. In May 2002, in *Quiepo v. Philip Morris,* a mistrial was declared and the case was subsequently dismissed. It has been reported that in February 2003, in *Seal v. Reynolds Tobacco,* a jury returned a verdict for the defendants. Most recently, in October 2003, a jury returned a verdict in favor of the defendants in *Routh v. Philip Morris*. As of August 1, 2003, Loews reports that approximately 12 additional *Broin II* cases are scheduled for trial by the end of 2003.

In *Scott v. American Tobacco Company, Inc.,* a Louisiana medical monitoring and/or smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and/ or monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also bring individual smoking and health lawsuits, if they desire. The trial court's certification of the class has survived initial appeal. Jury selection began in June 2001, and is now completed. In September 2002, the trial court entered an order precluding defendants from introducing evidence or making arguments to the jury concerning the affirmative defense of comparative fault. Also, in September 2002, the trial court issued an amended trial plan requiring the adjudication of defendants' liability to the entire class, including defendants' affirmative defenses, based on a trial of the two class representatives' claims. Defendants filed writs challenging each of these rulings with the intermediate appellate court, which granted the writs and reversed and vacated both of the trial court's September 2002 rulings. Plaintiffs petitioned the Louisiana Supreme Court for review of the intermediate appellate court's rulings. In November 2002 the Louisiana Supreme Court found the lower courts acted prematurely in considering the applicability of comparative fault principles prior to any adjudication relating to defendants' liability for damages and concluded that the initial phase of the trial should be structured to solely determine defendants' liability for all damages. The initial phase of the trial began in January 2003. In July 2003, the jury returned a split verdict, finding fraud but rejecting the plaintiff's remedy of a medical monitoring program. The judge has indicated that there will be a second phase to *Scott*, which will determine whether the industry will be required to fund a smoking-cessation-aid program throughout Louisiana.

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 have proposed that the class include all West Virginia residents who (1) on or after January 1, 1995, smoked cigarettes supplied by defendants; (2) smoked at least a pack a day for five years without having developed any of a specified list of tobacco-related illness; and (3) do not receive health care paid or reimbursed by the state of West Virginia. Trial began in January 2001. On January 25, 2001, the trial court granted a motion for a mistrial, ruling that the plaintiffs had improperly introduced testimony about addiction to smoking as a basis for claiming

damages. In March 2001, the court denied the defendants' motion to decertify the class. The retrial began in September 2001, and on November 14, 2001 the jury returned a verdict that defendants were not liable for funding the medical monitoring program. Plaintiffs' motion for another retrial was denied in January 2002 and plaintiffs have appealed.

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 began in June 2003.

In *Daniels v. Philip Morris, et al.,* a California state court case, the court certified a class comprising 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. Certification was granted as to plaintiff's claims that defendants violated the state's unfair business practice laws. On September 12, 2002, the trial court judge granted the defendants' motion for summary judgment on First Amendment and preemption (Federal Cigarette Labeling and Advertising Act) claims. In November 2002, the court confirmed its earlier rulings granting defendant's motion for summary judgment. The plaintiffs are currently appealing the dismissal. 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 comprising 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 Professions Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiff's claims under the California Legal Remedies Act. Defendants' writ with the court of appeals challenging the trial court's class certification was denied on January 16, 2002. The trial has been scheduled for September 2003.

On May 23, 2001, a lawsuit was filed in the United States District Court for the District of Columbia (*Sims, et al. v. Philip Morris Incorporated, et al.*) which seeks class action status for millions of youths who began smoking cigarettes before their eighteenth birthday. Plaintiffs seek to recover moneys that underage smokers spent on cigarettes before their eighteenth 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. In February 2003 the District Court denied class certification for the case.

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 cancer and/or other health effects have resulted from an individual's 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 warranty, breach of special duty, conspiracy, concert of action, violations of antitrust and consumer protection statutes and claims under federal and state RICO statutes. The tobacco industry has traditionally defended individual smoking and health 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. Loews has reported that as of November 1, 2003, there were approximately 1,235 smoking and health cases pending in the United States against it (many of which cases include other tobacco industry defendants), including approximately 1,100 cases pending before a single West Virginia state court in a consolidated proceeding that began in June 2003.

In addition, approximately 2,800 additional individual cases (referred to herein as the *Broin II* cases) are pending in Florida by individual current and former flight attendants claiming personal injury allegedly related to ETS in airline cabins. The individuals in the *Broin II* cases are limited by the settlement of a previous class action lawsuit, *Broin v. Philip Morris* (known as *Broin I*), to the recovery of compensatory damages only, and are precluded from seeking or recovering punitive damages. As a result of the settlement, however, the burden of proof

as to whether ETS causes certain illnesses such as lung cancer and emphysema was shifted to the tobacco industry defendants. The defendants' subsequent appeal was dismissed as premature without a ruling on the merits. See also "—*Class Action Lawsuits*" above.

By way of example only, and not as an exclusive or complete list, the following matters are illustrative of individual cases. In the last five years, there have been at least thirteen 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 of the PMs. Most recently, on November 4, 2003, in *Thompson v. Philip Morris*, a Missouri jury awarded nearly $1.6 million in compensatory damages to a sick smoker, and $500,000 in compensatory damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W, and the remaining 50% to plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. Philip Morris has stated that it will ask the court to set aside the verdict. If the verdict is not set aside, Philip Morris intends to appeal. In May 2003, in *Boerner v. Brown & Williamson*, an Arkansas jury awarded the plaintiff $15 million in punitive damages and $4 million in compensatory damages. B&W appealed the verdict and the U.S. District Court for the Eastern District of Arkansas dismissed the punitive damage award and affirmed the award of compensatory damages. Also, in April 2003, in *Eastman v. Philip Morris*, a Florida jury awarded a smoker $3.255 million in damages, after reducing the award to reflect the plaintiff's responsibility. Philip Morris has expressed intent to appeal the verdict. In September 2002, in *Bullock v. Philip Morris, Inc.,* a Los Angeles, California jury awarded a smoker $850,000. In October 2002, the same jury awarded the plaintiff $28 billion in punitive damages. On December 19, 2002, the trial judge reduced the punitive damage award to $28 million. Philip Morris has filed post-trial motions challenging the verdict and the reduced punitive damage award. The plaintiff also has appealed the reduction in punitive damages. In September 2002, in *Cruz-Vargas v R.J. Reynolds Tobacco Co.,* a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each. The trial judge vacated one of the awards on statute of limitations grounds, and granted Reynolds Tobacco's motion for judgment as a matter of law on the other award. On March 22, 2002, an Oregon jury in *Schwarz v. Philip Morris Incorporated* found in favor of the estate of a smoker against Philip Morris alleging that it falsely claimed that low-tar cigarettes are healthier than regular cigarettes. The jury awarded plaintiff approximately $119,000 in economic damages, $50,000 in non-economic damages and $150 million in punitive damages. The trial judge subsequently reduced the total damages awarded to $100 million. Philip Morris and the plaintiff have appealed the award. On February 22, 2002, a Kansas jury in *Burton v. R.J. Reynolds Tobacco Co., et al.* awarded $198,400 in compensatory damages in a product liability lawsuit against Reynolds Tobacco and B&W. Both OPMs have stated they will appeal the verdict. The jury also determined that punitive damages were appropriate against Reynolds Tobacco, and on June 21, 2002, the trial judge ordered the OPM to pay $15 million in punitive damages. Reynolds Tobacco has appealed the judgment to the U.S. Court of Appeals for the Tenth Circuit. On December 12, 2001, a Florida state court jury in *Kenyon v. Reynolds Tobacco* awarded the plaintiff $165,000 in compensatory damages finding that some of Reynolds Tobacco's products were defective. The jury declined to award punitive damages. Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which affirmed the trial court's judgment. Reynolds Tobacco has filed a petition for rehearing which is pending. In August 2003, Reynolds Tobacco paid this claim. On June 6, 2001, a California jury found against Philip Morris in *Boeken v. Philip Morris Incorporated et al.* 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. On September 7, 2001, Philip Morris appealed to the California Court of Appeal. In November 2000, the Florida Supreme Court reinstated a $750,000 award in *Carter et al. v. Brown & Williamson Tobacco Corp.* for a former smoker that developed lung cancer after smoking for 44 years. 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. The United States Supreme Court denied B&W's petition for a writ of certiorari on June 29, 2001, thus leaving the jury verdict intact. In October 2000, a Tampa, Florida, jury in *Jones v. R.J. Reynolds Tobacco Co.,* a wrongful death case, found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages. The jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002, the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff has 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. The trial judge subsequently reduced the punitive damages award to $32 million but the reduction was overturned and the full amount of punitive damages awarded was reinstated in June 2002 by the Oregon Court of Appeals. Philip Morris filed a motion for reconsideration. In December 2002, the Oregon Supreme Court declined to review the reinstated punitive damage award and Philip Morris has petitioned the United States Supreme Court for further review. On October 6, 2003, the United States Supreme Court set aside the Oregon appellate court's decision and directed it to reconsider the case in view of its decision in *State Farm v. Campbell*, which held that in cases involving substantial actual or compensatory damages, punitive damages should generally not exceed the amount of compensatory damages. Philip Morris has stated that it intends to ask the Oregon Court of Appeals to order a new trial on all issues. 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). The *Henley* case was upheld on appeal to the California state appeals court but has been appealed to the California Supreme Court, which accepted the appeal in January 2002. In October 2002, the California Supreme Court vacated the decision of the District Court of Appeals and remanded the case back to the District Court of Appeals for further consideration. In March 2003, the appeals court reaffirmed its earlier approval of the verdict. Philip Morris appealed to the California Supreme Court, which again remanded the case to the District Court for reconsideration under the *State Farm* ruling. It has been reported that the District Court has reduced the award to $9 million.

Health Care Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including union health and welfare funds, Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals, taxpayers and others, are seeking reimbursement of health care cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled health care cost recovery claims for the Settling States. As of August 1, 2003, there were an estimated 42 health care cost recovery cases pending in courts in the United States against manufacturers of tobacco products, according to one OPM. Of these, approximately 10 were filed by union trust funds. On May 22, 2001, three of such 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. On March 3, 2000, a New York state court granted motions to dismiss ten union cases, brought by 14 union trust funds, in *Eastern States Health & Welfare Fund v. Philip Morris, Inc.* The plaintiffs in this group of cases noticed appeals to the Appellate Division of the Supreme Court of New York. However, the plaintiffs never perfected the appeals which resulted in the appeals being dismissed.

Although there have been decisions to the contrary, most lower courts which have decided motions in these cases have dismissed all or substantially all of the claims against the tobacco industry. In addition, nine federal circuit courts of appeals, the Second, Third, Fifth, Sixth, 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. The United States Supreme Court has denied plaintiffs' petitions for writs of certiorari in the cases decided by the Court of Appeals for the Second, Third, Fifth, Ninth and District of Columbia Circuits, effectively refusing to consider plaintiffs' appeals.

In June 2001, in a U.S. District Court in Brooklyn, NY, a federal jury found that Philip Morris, R.J. Reynolds and Brown & Williamson engaged in deceptive business practices in a case brought by Empire Blue Cross Blue Shield of New Jersey. The jury awarded damages up to $17.8 million on statutory protection claims and $11.8 million on separate but overlapping claims. The jury rejected plaintiffs' RICO claim. On October 4, 2001, the Court denied defendants' post-trial motions. In February 2002, the District Court granted the plaintiffs' counsel's

request for attorney fees in the approximate amount of $37.8 million. Defendants are appealing both the final judgment and the attorneys' fees award to the United States Court of Appeals for the Second Circuit. On July 2, 2002, Judge Weinstein denied defendants' renewed motion to dismiss. He also refused to transfer the claims of non-New York plans to their respective states, and continued the stay of those claims until the U.S. Court of Appeals for the Second Circuit rules in defendants' appeal from the judgment reflecting the claims asserted at trial by Empire Blue Cross and Blue Shield. On September 16, 2003, the U.S. Court of Appeals for the Second Circuit ruled that Empire Blue Cross and Blue Shield was not entitled to recovery on its subrogated claims. With respect to Empire's statutory protection claims, the court certified two questions to the New York State Court of Appeals: (1) are Empire's claims too remote to permit recovery, and (2) if not, will individualized proof of harm to Empire's subscribers be required. The court reserved decision on the defendant's appeal of the attorney fee award pending the outcome of the two certified questions.

In September 1999, the Department of Justice filed a lawsuit against the OPMs and other defendants, seeking 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 RICO statute. The federal government has alleged that the tobacco companies have engaged in consumer fraud for failing to disclose health risks. In addition, other foreign governmental entities, union health and welfare funds, hospitals and insurers are seeking reimbursement of health care expenditures allegedly caused by tobacco products. On September 28, 2000, the district court granted the defendants' motion to dismiss the Medical Care Recovery Act and the Medicare Secondary Payer Act claims and rejected the defendants' motion to dismiss the RICO claims. In October 2000, the federal government moved for reconsideration of the district court's order to the extent that it dismissed the Medical Care Recovery Act claims for health care costs paid pursuant to government health benefit programs other than Medicare and the Federal Employees Health Benefits Act. The court denied that motion on January 31, 2001. The Department of Justice filed an amended complaint attempting to replead the Medicare Secondary Payer claim. A motion to dismiss the amended complaint was granted in July 2001. In June 2001, the Justice Department began to work on a possible settlement of the federal lawsuit. The Justice Department lawyers met with representatives of the tobacco industry, on July 18, 2001. No settlement was reached. In March 2003, the Department of Justice requested that the court award a disgorgement of $289 billion in proceeds from the defendants' allegedly illegal activity. It has been reported that on May 23, 2003, the court denied the defendant's motion for a partial summary judgment on certain claims based on advertising fraud and that Philip Morris has announced plans to file additional summary judgment motions to dismiss the entire suit. Trial is scheduled for September 2004 on the remaining RICO claims.

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 May 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 health care provided to patients suffering from tobacco-related illnesses. The lawsuit seeks a minimum of $3.6 billion in damages. Defendants' motion to dismiss the complaint was granted on December 14, 2001. On January 17, 2002, plaintiffs moved to appeal the dismissal of the complaint. On February 10, 2003, the Appellate Division of the New York Supreme Court affirmed the dismissal, and on May 13, 2003 the New York State Court of Appeals denied plaintiffs' motion for leave to appeal. 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.* On October 1, 2001, the U.S. Supreme Court denied the motion for a writ of certiorari. In October 2001, in *Allegheny General Hospital, et al. v. Philip Morris, et al.,* the Third Circuit Court of Appeals affirmed the dismissal of a complaint filed against various tobacco industry defendants, including PMs, brought by a group of Pennsylvania hospitals seeking to recover unreimbursed health care costs related to treating patients with tobacco-related illnesses.

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 health care and medical and other assistance paid by those foreign governments to their citizens. The cases brought in the United States include actions brought by Belize, Bolivia, Ecuador, Guatemala, Honduras, Nicaragua, the Province of Ontario, Canada, Panama, the Russian Federation, Tajikistan, Ukraine, Venezuela, 11 Brazilian states and 11 Brazilian cities. The actions brought by these entities were consolidated for pre-trial purposes and transferred to the United States District Court for the District of Columbia. The district court dismissed the cases brought by Guatemala, Nicaragua, Ukraine and the Province of Ontario, and the dismissals are now final. The district court has remanded to state courts the remaining cases,

except for the cases brought by Bolivia and Panama. Subsequent to remand, the Ecuador case was voluntarily dismissed. In November 2001, the cases brought by Venezuela and the Brazilian state of Espirito Santo were dismissed by the state court, and Venezuela appealed. In September 2002, the appellate court affirmed the dismissal of the case brought by Venezuela, and Venezuela has petitioned the state supreme court for further review. In addition to cases brought in the United States, health care cost recovery actions have also been brought in Israel, the Marshall Islands (dismissed), the Province of British Columbia, Canada, France and Spain, and other entities have stated that they are considering filing such actions.

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

- 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 November 1, 2003, an estimated seven suits were pending on behalf of former asbestos manufacturers, asbestos manufacturers' personal injury settlement trusts and an insurance company against domestic 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 injuries were too remote to recover damages for the asbestos injury claims. Owens Corning appealed the dismissal to the Mississippi Supreme Court on August 15, 2001. Similar claims in *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.

- 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.

- A number of tobacco wholesalers, or indirect purchasers, have sued 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. As of November 1, 2003, there were approximately 40 putative class actions and one additional case pending against domestic cigarette manufacturers. In all cases, 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 individual states or throughout the United States, and throughout the world, that purchased cigarettes directly from one or more of the defendants. The seven federal cases have been consolidated and sent by the Judicial Panel on Multidistrict Litigation to 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 July 11, 2002, the District Court dismissed all of the plaintiffs' antitrust claims. Plaintiffs appealed to the U.S. Court of Appeals for the Eleventh Circuit on July 19, 2002. On September 22, 2003, the Court of Appeals affirmed the order of the District Court. At the state level, Michigan, North Dakota and New Mexico courts denied defendants' motions to dismiss on June 11, 2002, June 25, 2002 and July 8, 2002, respectively, while in New York and Florida, state court cases on behalf of indirect purchasers have been dismissed. An Arizona indirect purchaser suit was dismissed by the trial court on February 28, 2002, but the dismissal was reversed on appeal,

and an appeal from the reversal to the Arizona Supreme Court was argued in January 2003. In addition, on November 15, 2002, a District of Columbia court dismissed all claims arising prior to May 11, 1996. A Minnesota court denied class certification on November 21, 2001. A Kansas court granted class certification on November 15, 2001 and trial in this case is scheduled for September 2003. In February 2003, defendants' motion to dismiss the case pending in state court in Florida was granted. 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. It has been reported that on May 16, 2003, all but one of the defendants reached a settlement with the plaintiffs. The settlement calls for the settling defendants to make a $200 million cash settlement to farmers named in the class and to buy a set portion of their tobacco leaf from the U.S. growers over the next decade. Reynolds Tobacco did not participate in the settlement and trial is scheduled for April 2004.

- Lawsuits were filed in Florida by the Republic of Ecuador, the Republic of Belize and the Republic of Honduras, alleging that various OPMs engaged in sophisticated conspiracies to smuggle cigarettes into those respective countries in an effort to evade duties and/or taxes. These lawsuits were dismissed in February 2002, and plaintiffs filed a notice of appeal on March 22, 2002. The dismissal of a similar lawsuit by several Canadian Provinces was upheld by the Second Circuit in October 2001.

- An action in the United States District Court for the Eastern District of New York commenced by the European Community ("**EC**") on November 3, 2000 against Reynolds Tobacco, Philip Morris, and related companies. The EC complaint alleges several claims, including RICO, negligence, fraud, and unjust enrichment. The EC 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. 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 10 member states filed a new complaint against Reynolds Tobacco, 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 EC has appealed to the U.S. Second Circuit Court of Appeals. In October 2002, the EC filed a separate suit against Reynolds Tobacco in the same New York court for alleged money-laundering. It has also been reported that three PMs filed suit in a European Union court, challenging the competency of the EC to bring each of the foregoing actions in the United States for tobacco smuggling and money laundering. On January 15, 2003, the Court of First Instance denied the request. Reynolds Tobacco is considering an appeal of that judgment.

- Litigation spawned by the MSA and settlements with the Previously-Settled States alleging, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, some of which, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA, and/or a determination that the MSA is void or unenforceable. Two of the cases that challenged the MSA also challenged the constitutionality of the Model Statute, although one of such cases has been dismissed with prejudice. To date none of the challenges to the MSA or the Model Statute have been successful, although several of the cases brought in federal district courts are on appeal. See

"BONDHOLDERS' RISKS" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" herein.

- There are three 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 and that decision was affirmed on appeal. Appeals of all of these decisions are pending. Trial in the Washington matter has been dismissed. 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. On April 25, 2002, the Ohio court ruled in favor of Reynolds Tobacco but was subsequently reversed on appeal. 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. Reynolds Tobacco has appealed the ruling.

- 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.

- Class action lawsuits 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. On September 11, 2000, plaintiffs in *Temple, et al. v. Tennessee, et al.* filed a complaint in federal court seeking class certification of those individuals who are Medicaid recipients who have allegedly suffered from smoking-related injuries. Plaintiffs claim that the MSA funds belong to individuals and they further seek a declaration that the MSA is unconstitutional. As of June 30, 2002, the action remained pending. In January 2002, in *Greenless v. Almond,* the U.S. Court of Appeals for the First Circuit upheld the dismissal of a class action in which the plaintiff's claim was the same as that of the plaintiffs in *Temple*. The appeals court noted that the plaintiffs are barred by Congress from collecting any portion of the MSA funds, citing that Congress passed an amendment to the Medicaid Statute in 1999. A similar Medicaid case has been filed by an HMO plaintiff in New Jersey State courts, *Americhoice of New Jersey v. State of New Jersey;* the State has filed motions to dismiss which are pending.

- In August 2002, in *Myers v. Philip Morris* and *Naegele v. R.J. Reynolds,* the California Supreme Court interpreted California statutes granting immunity to tobacco manufacturers from suit based on conduct during the period 1988 to 1998 and held that such statutes grant product liability immunity for conduct during such period unless it is alleged that any such company "used additives that exposed smokers to dangers beyond those commonly known to be associated with cigarette smoking."

- OPMs have been served in at least nine reparation actions brought by descendants of slaves. Plaintiffs in these actions claim that defendants made a profit from the use of slave labor.

- In *Lone v. R.J. Reynolds*, the Mississippi Supreme Court held that a state statue precluded all tobacco cases based on product liability theories.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the Corporation's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs and other publicly available information published by the OPMs and others, including recent news reports. Prospective purchasers of the Series 2003B Bonds are referred to the reports filed with the SEC by certain of the OPMs 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. The ultimate outcome of these and any other pending or future lawsuits is uncertain. Unfavorable verdicts of substantial magnitude, or others like them if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the Global Insight Report and resulting in a reduction in Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Series 2003B Bonds. In addition, the financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs and/or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA, thus materially adversely affecting the amount of Pledged Settlement Payments available to the Corporation to pay principal and Sinking Fund Installments of and interest on the Series 2003B Bonds.

APPENDIX G

DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS

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APPENDIX G

DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS

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 Pledged Revenues Account, the Operating Account, the Debt Service Account, the Debt Service Reserve Account, the Supplemental Account, the Costs of Issuance Account, the Rebate Account and any accounts established by Series Supplement, all of which shall be established and held by the Trustee.

"Ancillary Bond Facility" means the Contingency Contract and any Interest Rate Exchange or Similar Agreement or any bond insurance policy, letter of credit or other credit enhancement facility, liquidity facility, guaranteed investment or reinvestment agreement, or other similar agreement, arrangement or contract pledged as Collateral under the Indenture.

"Ancillary Contracts" means the "ancillary bond facilities", as defined in the Act, constituting contracts entered into by the Corporation pursuant to the provisions of the related Series Supplement or other Supplemental Indenture, for its benefit or the benefit of any of the Beneficiaries, to facilitate the issuance, sale, resale, purchase, repurchase or payment of Bonds, including any bond insurance, letters of credit and liquidity facilities, investment agreements and forward delivery agreements with respect to Eligible Investments, but excluding Swap Contracts.

"Authorized Officer" means: (i) in the case of the Corporation, the Chairman, Vice Chairman, Executive Director, any Senior Vice President, their successors in office, and any other person authorized to act under the Indenture by appropriate Written Notice to the Trustee, and (ii) in the case of the Trustee, any officer assigned to the Corporate Trust Office, including any managing director, director, vice president, assistant vice president, associate, assistant secretary, authorized signer or any other officer of the Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of the Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Beneficiaries" means Bondholders, the owner of the Series 2003B Residual Certificate and, to the extent specified in the related Series Supplement or other Supplemental Indenture, the party or parties to Swap Contracts and Ancillary Contracts.

"**Bond Purchase Agreement**" means collectively the Bond Purchase Agreements by and between the Corporation and the underwriters of the applicable series of the Series 2003B Bonds, relating to the sale of the Series 2003B Bonds, in such form as the parties thereto shall agree.

"Bondholders" or **"Holders"** or similar terms mean the registered owners of the Bonds registered as to principal and interest or as to principal only, as shown on the books of the Trustee.

"Bonds" means all obligations issued as summarized in the caption herein entitled "THE INDENTURE – Bonds of the Corporation."

"Broker-Dealer Fees" means the fees paid to the broker-dealers for the Auction Rate Bonds, as set forth in the related Series Supplement.

"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.

"Code" or **"Tax Code"** means the Internal Revenue Code of 1986, as amended.

"Collateral" has the meaning as set forth herein under the caption "THE INDENTURE – Security and Pledge."

"Complementary Legislation" means sections 480-b, 481(1)(c) and 1846(a-1) of the Tax Law of the State.

"Contingency Contract" means (i) with respect to the Series 2003B Bonds, that certain Tobacco Settlement Financing Corporation Contingency Contract, dated as of December 1, 2003, by and between the Corporation and the State, as the same may be amended or supplemented in accordance with its terms, and (ii) with respect to any Series of Refunding Bonds, any Contingency Contract, identified as such in a Series Supplement or other Supplemental Indenture, between the Corporation and the State, pursuant to which the State agrees to pay to the Corporation, under certain circumstances and subject to appropriation by the State Legislature, such amounts as are necessary to meet the debt service requirements on such Refunding Bonds in any year.

"Costs of Issuance" means those "costs of issuance", as defined in the Act, related to the authorization, sale or issuance of Bonds, including but not limited to all fees, costs, expenses and governmental charges for underwriting and transaction structuring, auditors or accountants, printing, reproducing documents, filing and recording of documents, fiduciaries, legal services, financial advisory and professional consultants' services, credit ratings, credit and liquidity enhancements, execution, and transportation and safekeeping of Bonds; and also includes costs incurred by the State to the extent the same are to be paid by the Corporation in accordance with the Sale Agreement.

"Debt Service" means interest, redemption premium, principal and Sinking Fund Installments due on Outstanding Bonds.

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

"Defeasance Collateral" means money and, to the extent lawful for investment of funds of the Corporation, any of the following:

(a) 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, (which do not include obligations of FNMA or the FHLMC), 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") 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 shall exclude investments in mutual funds and unit investment trusts;

(b) non-callable 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);

(c) certificates rated in one of the two highest long-term rating categories by S&P, Moody's and Fitch (if rated by Fitch) evidencing ownership of the right to the payment of the principal of and 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 Trustee in a segregated trust account in the trust department separate from the general assets of such custodian;

(d) 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, (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 and (z) rated "AAA"

by S&P and in one of the two highest long-term rating categories by Moody's and Fitch (if rated by Fitch); and

(e) investment arrangements rated in the highest long-term and short-term rating categories by each Rating Agency.

"Defeased Bonds" means Bonds that remain in the hands of their Holders, but are deemed no longer Outstanding as specified under the Indenture.

"Distribution Date" means (1) each June 1 and December 1 commencing June 1, 2004, or if such date is not a Business Day, the following Business Day, (2) each additional Distribution Date selected by the Corporation or the Trustee following an Event of Default, and (3) each additional Distribution Date, to the extent specified in a Supplemental Indenture.

"Eligible Investments" means, as set forth in the Act, (a) general obligations of, or obligations guaranteed by, any state of the United States of America or political subdivision thereof, or the District of Columbia or any agency or instrumentality of any of them, receiving one of the three highest long-term unsecured debt rating categories available for such securities of at least one independent rating agency, (b) certificates of deposit, savings accounts, time deposits or other obligations or accounts of banks or trust companies in the State, secured, if the Corporation shall so require, in such manner as the Corporation may so determine, and (c) obligations in which the State Comptroller is authorized to invest, pursuant to either Section 98 or 98-a of the State Finance Law, and (d) any of the following:

(i) Defeasance Collateral;

(ii) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, FHLMC, FNMA, the Federal Farm Credit System or the Federal Home Loan Bank (FHLB) 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 at least "F-1" by Fitch (if rated by Fitch), "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, territory or possession thereof, the District of Columbia or any political subdivision of any of the foregoing rated at least "Aal" by Moody's and receiving one of the two highest long-term unsecured debt ratings available for such securities by S&P and Fitch (if rated by Fitch);

(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 190 days after the date of issuance thereof) that is rated at least "F-1" by Fitch (if rated by Fitch), "A-1" by S&P and "P-1" by Moody's (and, if longer than 100 days but no longer than 190 days, rated at least "A", "A" and "A1", respectively);

(vi) repurchase obligations with respect to any security described in clause (i), (ii), (iv) or (v) above entered into with a primary dealer, depository institution or trust company (acting as principal) rated at least "F-1" by Fitch (if rated by Fitch), "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 "A3" by Moody's and in one of the three highest long-term rating categories by S&P and Fitch (if rated by Fitch) or collateralized by securities described in clause (i), (ii), (iv) or (v) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal

Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored with five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%;

(vii) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than 190 days after the date of issuance thereof) that are issued by any single corporation incorporated under the laws of the United States of America or any state thereof and rated at least "F-1" by Fitch (if rated by Fitch), "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, 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 "Aal" by Moody's, in one of the two highest categories by Fitch (if rated by Fitch) and at least "Aam" or "AAm-G" by S&P, including if so rated any such fund which the Trustee or an affiliate of the Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (a) the Trustee or an affiliate of the Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (b) the Trustee charges and collects fees and expenses for services rendered pursuant to the Indenture, and (c) services performed for such funds and pursuant to the Indenture may converge at any time (the Corporation specifically authorizes the Trustee or an affiliate of the Trustee to charge and collect all fees and expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Trustee may charge and collect for services rendered pursuant to the Indenture);

(ix) 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 or corporation whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, at least "F-1" by Fitch (if rated by Fitch), "A3/P1" by Moody's and in one of the three highest long-term rating categories by S&P if the Corporation has an option to terminate such agreement in the event that any such rating is either withdrawn or downgraded below the rating on the Bonds, or if not so rated, then collateralized by securities described in clause (i), (ii), (iv) or (v) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each Rating Agency, provided that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Trustee or an independent third party acting solely as agent for the Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Trustee, (3) the agreement has a term of thirty days or less, or the Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored with seven Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102%;

(x) with respect to any Series of Bonds, the investment contracts constituting Ancillary Contracts, as set forth in the related Series Supplement or other Supplemental Indenture; and

(xi) soley for investment of money in the Supplemental Account, Non-AMT Tax Exempt Obligations; provided, however, 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 Trustee, any representative of the Holders of Bonds appointed by Series Supplement, and each Paying Agent, if any.

"**Financing Costs**" means (1) Costs of Issuance, (2) capitalized interest, (3) the capitalization of initial operating expenses of the Corporation, (4) the funding of the debt service reserves, (5) fees and costs for Ancillary Bond Facilities, and (6) any other fees, discounts, expenses and costs of any kind whatsoever related to issuing, securing and marketing the Bonds, including, without limitation, bond insurance premiums, and any net original issue discount.

"Fiscal Year" means the twelve (12) month period commencing November 1 of each year and ending on October 31 of the succeeding year.

"**Fitch**" means Fitch, Inc.; references to Fitch under the Indenture are effective so long as Fitch is a Rating Agency.

"FNMA" means Fannie Mae.

"Funds" means funds or accounts established under the Indenture and by Series Supplement.

"Majority in Interest" means as of any particular date of calculation the Holders of a majority of the Outstanding Bonds eligible to act on a matter, measured by Outstanding principal amount, payable at maturity, or, in the case of a Bond specifically designated in a Series Supplement as having Accreted Value, by the Accreted Value of such Outstanding Bonds as of such date.

"Maximum Rate" means (1) the highest rate payable on a Bond to Holders other than parties to Ancillary Contracts, as specified by Series Supplement or (2) the rate specified by Series Supplement as the Maximum Rate on a Swap.

"**Moody's**" means Moody's Investors Service; references to Moody's under the Indenture are effective so long as Moody's is a Rating Agency.

"Non-AMT Tax-Exempt Obligations" means a debt obligation the interest on which (i) is excludable from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code and (ii) is not a preference item for purposes of computing alternative minimum tax by reason of Section 57(a)(5) of the Tax Code.

"Operating Expenses" means all operating and administrative expenses incurred by the Corporation, and all operating and administrative expenses incurred by the State of New York Municipal Bond Bank Agency and related (as set forth in a certificate of an Authorized Officer of the Corporation) to such Agency's activities on behalf of or in assistance to the Corporation, including but not limited to, the cost of preparation of accounting and other reports, costs of maintenance of ratings on the Bonds, arbitrage rebate and penalties, salaries, administrative expenses, insurance premiums, fees and charges of the State (including the State Fee) auditing and legal expenses, fees and expenses incurred for the Trustee, any Paying Agents, professional consultants and fiduciaries, the fees of any Auction Agent or Broker-Dealer, costs of any Contract, costs incurred to preserve the tax-exempt status of any Tax-Exempt Bonds, costs related to the enforcement rights with respect to the Indenture, the MSA, the Sale Agreement, the Qualifying Statute, the Complementary Legislation or the Bonds and all other Operating Expenses so identified in the Indenture.

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

"Outstanding" means, with respect to Bonds, all Bonds issued under the Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against a principal payment: (ii) Bonds that have been paid, or, as set forth in the applicable Series Supplement, purchased by the Corporation; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which (A) there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them and (B) any required notice of redemption shall have been duly given in accordance with the Indenture or irrevocable instructions to give notice shall have been given to the Trustee; (v) Bonds the payment of which shall have been provided for pursuant to 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 under the Indenture, Bonds held by or for the account of the Corporation, the State or any person controlling, controlled by or under common control with either of them. For the purposes of this definition, "control," when used with respect to any specified person, means the power to direct the management and policies of such person, directly or indirectly, whether through the ownership of voting securities, by law or contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Permitted Indebtedness" means (i) Bonds, (ii) borrowings to pay Operating Expenses as described in the Indenture, (iii) bonds or other obligations payable solely from Previously Purchased and Pledged Settlement Payments and Unsold Settlement Payments, and (iv) indebtedness secured by specified assets of the Corporation not subject to the lien of the Indenture and the holders of which expressly have no recourse to any other assets of the Corporation pledged under the Indenture in the event of non-payment.

"**Portion of the State's Share**" means fifty percent (50%) of the State's Share less the Unsold Settlement Payments.

"Presumed Auction Rate" means with respect to any Auction Rate Bonds, (i) for the Series 2003B Bonds and during the period ending on December 1, 2004, the Maximum Rate, and (ii) otherwise, the greatest of (a) the actual average rate of interest on the Auction Rate Bonds for the immediately preceding twelve months plus 250 basis points, (b) the actual average rate of interest on the Auction Rate Bonds for the immediately preceding six months plus 250 basis points or (c) the presumed Fixed Rate less the Broker-Dealer Fees.

"Presumed Fixed Rate" means, as set forth in the Series Supplement, the hypothetical rate which it is presumed the Auction Rate Bonds would have borne had they been issued at a fixed rate of interest. The Presumed Fixed Rate is assumed to be an all-in rate which includes Broker-Dealer Fees.

"Rating Agency" means each nationally recognized statistical rating organization that has, at the request of the Corporation, a rating in effect for any of the Bonds.

"Record Date" means the last Business Day of the calendar month preceding a Distribution Date; provided that with regard to Auction Rate Bonds, "Record Date" shall have the meaning set forth in the related Series Supplement, or such other date as may be specified by the Indenture, a Series Supplement or Supplemental Indenture or an Officer's Certificate; and the Corporation or the 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 Trustee.

"Refunding Bonds" means Bonds issued to renew or refund any Bonds, by exchange, purchase, redemption or payment.

"Series Supplement" means a Supplemental Indenture as identified under the caption "THE INDENTURE - Bonds of the Corporation" below.

"Sinking Fund Installment" means a scheduled amount set forth in the applicable Series Supplement for required amortization prior to maturity of a Term Bond.

"**S&P**" means Standard & Poor's Ratings Services; references to S&P under the Indenture are effective so long as S&P is a Rating Agency.

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

"Supplemental Indenture" means a Series Supplement or supplement adopted pursuant to the Indenture and becoming effective in accordance with the terms of the Indenture. Any provision that may be included in a Series Supplement or Supplemental Indenture is also eligible for inclusion in the other subject to the provisions of the Indenture.

"Swap" or **"Swap Contract"** means one of the "ancillary bond facilities", as defined in the Act, constituting an interest rate exchange (in currency of the United States only), cap, collar, hedge or similar agreement entered into by the Corporation, meeting the requirements as summarized below under the caption "THE INDENTURE - Swap Contracts and Ancillary Contracts" and under which all payments required to be made by the Corporation constitute Junior Payments.

"**Transaction Documents**" means the Sale Agreement, Contingency Contract, the Indenture and the Bond Purchase Agreement.

THE INDENTURE

The following summary describes certain terms of the Indenture pursuant to which the Series 2003B 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 and the Series 2003B Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS" for further descriptions of certain terms and provisions of the Series 2003B Bonds.

Directors and Officers Not Liable on Bonds

Neither the members, directors or officers of the Corporation nor any person executing Bonds, Ancillary Contracts, Swap Contracts, or other obligations of the Corporation nor any official, employee or agent of the Corporation shall be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery thereof.

PURSUANT TO THE ACT, NEITHER ANY BOND NOR ANY ANCILLARY CONTRACT OF THE CORPORATION SHALL CONSTITUTE A DEBT OR MORAL OBLIGATION OF THE STATE OR A STATE SUPPORTED OBLIGATION WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY PROVISION OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OR OF THE TAXING POWER OF THE STATE, AND THE STATE SHALL NOT BE LIABLE TO MAKE ANY PAYMENTS THEREON NOR SHALL ANY BOND OR ANY ANCILLARY CONTRACT BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN PLEDGED TOBACCO REVENUES AND OTHER ASSETS, IF ANY SOLD TO THE CORPORATION AND OTHER FUNDS AND ASSETS OF OR AVAILABLE TO THE CORPORATION PLEDGED THEREFOR, AND THE BONDS AND ANY ANCILLARY CONTRACT OF THE CORPORATION SHALL CONTAIN ON THE FACE THEREOF OR OTHER PROMINENT PLACE THEREON A STATEMENT TO THE FOREGOING EFFECT. (Section 1.03)

Separate Accounts and Records

The parties to the Indenture represent and covenant, each for itself, that: (a) the Corporation and the 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 the Corporation and the 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) the Corporation has paid and will pay its liabilities and losses from its separate assets. In furtherance of the foregoing, the Corporation

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 1.04)

Security and Pledge

Pursuant to the Indenture, the Corporation will assign and pledge to the Trustee and, pursuant to the Act, will grant a first lien on and a first priority security interest in, in trust upon the terms of the Indenture, the "**Collateral**" consisting of (subject to the next two succeeding sentences): (a) the Pledged Revenues (including all Pledged Settlement Payments and payments on Contracts), (b) all rights to receive the Pledged Revenues and the proceeds of such rights, (c) the Pledged Accounts and assets thereof (including Swap Contracts and Ancillary Contracts), including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture, (d) subject to the following sentence, all rights and interest of the Corporation under the Sale Agreement and Contracts, including the representations, warranties and covenants of the State in the Sale Agreement and in Contingency Agreements, and (e) any and all other property of every kind and nature from time to time hereafter, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. Except as specifically provided in the Indenture, this assignment and pledge does not include: (i) the Previously Purchased and Pledged Settlement Payments, (ii) the Unsold Settlement Payments, (iii) the rights of the Corporation pursuant to provisions for consent or other action by the Corporation, notice to the Corporation, indemnity or the filing of documents with the Corporation, or otherwise for its benefit and not for that of the Beneficiaries, (iv) any right or power reserved to the Corporation pursuant to the Act or other law, (v) any Defeasance Collateral held by the Trustee for the benefit of Defeased Beneficiaries in accordance with the Defeasance provisions of the Indenture, and (vi) as to any Series of Bonds identified in a Series Supplement, any other property or interest explicitly excluded from Collateral pursuant to the terms of the related Series Supplement; nor do the Security and Pledge provisions of the Indenture preclude the Corporation's enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. The Previously Purchased and Pledged Settlement Payments, the Unsold Settlement Payments and the proceeds of the Bonds, other than the amounts deposited in the Debt Service Reserve Account or the Debt Service Account do not constitute any portion of the Pledged Revenues, are not pledged to the holders of the Bonds and are not subject to the lien of the Indenture. The right of the Corporation to receive the Pledged Settlement Payments is valid and enforceable and, during the respective periods that Pledged Settlement Payments are payable to the Corporation and pledged under the Indenture, the right of the Corporation to receive the Pledged Settlement Payments is on a parity with and is not inferior or superior to the right of the Series 2003A Trustee (or any future assignee or any successor of the Series 2003A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State (or any future assignee or future purchaser of any portion of the Unsold Settlement Payments) to receive the Unsold Settlement Payments. Neither the Corporation nor the Trustee, any Beneficiary or other person or entity shall have the right to make a claim to make up all or any portion of a perceived deficiency in Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee (nor any future assignee or successor of the Series 2003A Trustee) nor the State (nor any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) shall have any right to make a claim to make up all or any portion of a perceived deficiency in the Previously Purchased and Pledged Settlement Payments or Unsold Settlement Payments from the Pledged Settlement Payments. The Corporation will implement, protect and defend this assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. The Collateral is to be pledged to secure the payment of Bonds, Swap Contracts and Ancillary Contracts, all with the respective priorities specified in the Indenture. The pledge and assignment made by the Indenture and the covenants and agreements to be performed by or on behalf of the Corporation shall be for the equal and ratable benefit, protection and security of the Holders of any and all of the Outstanding Bonds and all other Beneficiaries, all of which, regardless of the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of such Bonds and all other Beneficiaries over any other Bonds or Beneficiaries except as expressly provided in the Indenture or permitted thereby. The lien of such pledge and the obligation to perform the contractual provisions in the Indenture made shall have priority over any or all other obligations and liabilities of the Corporation secured by the Pledged Revenues. The Corporation shall not incur any obligations, except as authorized in the Indenture, secured by a lien on the Pledged Revenues, or the Pledged Accounts equal or prior to the lien in the Indenture. (Section 2.01).

Defeasance

When (a) there is held by or for the account of the 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 or any portion of Outstanding Bonds in accordance with their terms and all or any portion of obligations to Beneficiaries (including parties to Swap Contracts and Ancillary Contracts) (the holders of said Bonds and such Beneficiaries called the "**Defeased Beneficiaries**") (to be verified by a nationally recognized firm of independent certified public accountants or other professionals expert in verifying bond defeasance escrows), (b) any required notice of redemption shall have been given in accordance with the Indenture or irrevocable written instructions to give notice shall have been given to the Trustee, (c) all the rights under the Indenture of the Fiduciaries have been provided for, then upon written notice from the Corporation to the Trustee, such Defeased Beneficiaries shall cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien under the Indenture, the security interests created by the Indenture with respect to such Defeased Beneficiaries (except in such funds and investments) shall terminate, and the Corporation and the Trustee shall execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture with respect to such Defeased Beneficiaries. Upon such defeasance, the funds and investments required to pay or redeem such Bonds and other obligations to such Defeased Beneficiaries shall be irrevocably set aside for that purpose, subject to certain provisions of the Indenture, and money held for defeasance shall be invested only Defeasance Collateral and applied by the Trustee and other Paying Agents, if any, to the retirement of such Bonds and such other obligations. When provision for payment or redemption is made in accordance under the "Defeasance" provisions of the Indenture for less than all the Bonds of a Series and maturity, the Trustee shall choose by lot the particular Bond or Bonds of such Series and maturity to be so paid or redeemed. Upon defeasance of all Outstanding Bonds and Beneficiaries, any funds or property held by the Trustee and not required for payment or redemption of such Bonds and such other obligations to Defeased Beneficiaries and Fiduciaries in full shall be distributed to the order of the Corporation. (Section 2.02)

Bonds of the Corporation

By Series Supplement complying procedurally and in substance with the Indenture, and including with any consent of the State Representative required by the terms of the related Series Supplement, the Corporation may authorize, issue, sell and deliver (1) the Series 2003B Bonds and (2) other Series of Refunding Bonds from time to time in such principal amounts as the Corporation shall determine and establish such escrows therefor as it may determine. Subsequent to the issuance of the Series 2003B Bonds, only Refunding Bonds may be issued and only upon receipt by the Corporation or the Trustee of a Contingency Contract for such Refunding Bonds. See "THE SECURITY AND SOURCE OF PAYMENTS FOR THE SERIES 2003 BONDS." (Section 3.01)

Accounts

There is established within the Indenture the Pledged Revenues Account, Operating Account, the Debt Service Account, the Debt Service Reserve Account, the Supplemental Account, the Costs of Issuance Account and the Rebate Account, and such other Accounts as may be established by Supplemental Indenture. (Section 4.01)

Swap Contracts and Ancillary Contracts

The Corporation may enter into, amend or terminate, as it determines to be necessary or appropriate, Swap Contracts or Ancillary Contracts with the approval (as required by the Act) of the State Representative and may by Series Supplement or other Supplemental Indenture provide for the receipt of payments thereunder as Pledged Revenues, and provide for the payment of amounts due from the Corporation thereunder as Junior Payments. (Section 4.05)

Redemption of the Bonds

The Corporation may redeem Bonds at its option in accordance with their terms and the terms of the applicable Series Supplement and, subject to certain provisions in the Indenture, will redeem Bonds in accordance with their terms pursuant to any mandatory redemption established by the Series Supplement. When Bonds are called for redemption, the accrued interest thereon shall become due on the redemption date. To the extent not otherwise provided, the Corporation shall deposit with the Trustee on or prior to the redemption date a sufficient sum to pay principal or Sinking Fund Installments, redemption premium, if any, and accrued interest.

Unless otherwise specified by Series Supplement, there shall, at the option of the Corporation, be applied to or credited against any sinking fund requirement the principal amount of any Bonds subject to redemption therefrom that have been purchased or redeemed and not previously so applied or credited. To the extent set forth in the applicable Series Supplement, Bonds purchased by the Corporation shall be promptly tendered to the Trustee for cancellation.

When a Bond is to be redeemed prior to its Maturity Date, the Trustee shall give notice in the name of the Corporation, which notice shall 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 Trustee or a Paying Agent. The notice shall further state that on such date there shall 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 Trustee or Paying Agent on or prior to the redemption date, from and after such date, interest thereon shall cease to accrue. The Trustee shall give 15 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Corporation. 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, shall not affect the redemption of any other Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by Written Notice by the Corporation to the Trustee no later than 5 days prior to the date specified for redemption. The Trustee shall give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons, as notice of such redemption was given as described above. In making the determination as to how much money will be available in the Supplemental Account on any Distribution Date for the purpose of giving notice of redemption under this paragraph, the Trustee shall take into account investment earnings which it reasonably expects to be available on or prior to such Distribution Date for application pursuant to the Indenture. Subject to the defeasance and redemption and payment provisions of the Indenture or by Series Supplement: (a) if less than all the Outstanding Bonds are to be redeemed pursuant to certain of the redemption provisions of the Indenture, the particular Bonds of a Maturity Date and Series to be redeemed shall be selected by the Trustee by such method as it shall deem fair and appropriate, and the Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination, and (b) the Trustee shall redeem any and all Bonds held by the provider of an Ancillary Contract prior to any other Bonds redeemed under the Indenture unless otherwise directed by an Officer's Certificate of the Corporation. (Section 4.06)

Investments

Pending its application under the Indenture, money in the Funds and Accounts may be invested by the Trustee pursuant to written direction of the Corporation 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. Specifically, Eligible Investments shall mature or be redeemable at the option of the Corporation in an amount and at such times sufficient to make certain payments under the Indenture on the next succeeding Distribution Date. Investments shall be held by the Trustee in the respective Funds and Accounts and shall be sold or redeemed to the extent necessary to make payments or transfers from each Fund or Account. The Trustee shall not be liable for any losses on investments made at the direction of the Corporation.

On the Business Day immediately preceding each Distribution Date, the Trustee shall value the money and investments in the Debt Service Reserve Account according to the methods set forth under the Investments provisions of the Indenture. Any amounts in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement shall be applied as provided under the Indenture.

In computing the amount in any Fund or Account, the value of Eligible Investments shall be determined by the Trustee at least as frequently as the Business Day preceding each Distribution Date and shall be calculated as follows:

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

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

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

(iv) As to any investment not specified above: the value thereof established by prior agreement between the Corporation and the Trustee (with written notice to Moody's of such agreement).

The Trustee may hold undivided interests in Eligible Investments for more than one Fund or Account (for which they are eligible) and may make inter-fund transfers in kind.

In respect of Defeasance Collateral held for Defeased Bonds, the provisions of the Indenture summarized under the caption "Investments" shall be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 4.07)

Rebate

(a) The Trustee shall establish and maintain an account separate from any other account established and maintained under the Indenture designated as the Rebate Account. Subject to the transfer provisions provided in paragraph (e) below, all money at any time deposited in the Rebate Account shall be held by the Trustee in trust, to the extent required to satisfy the Rebate Requirement (as defined, computed and provided to the Trustee in accordance with the Tax Certificate), for payment to the United States Treasury. Neither the Corporation nor any Bondholder shall have any rights in or claim to such money in the Rebate Account. All amounts deposited into or on deposit in the Rebate Account shall be governed by the rebate provisions and the tax covenants contained in the Indenture and by the Tax Certificate. The Trustee shall be deemed conclusively to have complied with such provisions if it follows such directions of the Corporation, and shall have no liability or responsibility to enforce compliance by the Corporation with the terms of the Tax Certificate.

(b) Upon the Corporation's written direction, an amount shall be deposited to the Rebate Account by the Trustee from amounts on deposit in the Operating Account so that the balance in the Rebate Account shall equal the Rebate Requirement. Computations of the Rebate Requirement shall be furnished by or on behalf of the Corporation in accordance with the Tax Certificate. The Trustee shall supply to the Corporation all information required to be provided in the Tax Certificate to the extent such information is reasonably available to the Trustee.

(c) The Trustee shall have no obligation to rebate any amounts required to be rebated pursuant to the rebate provisions of the Indenture, other than from moneys held in the Operating Account or the Rebate Account created under the Indenture.

(d) At the written direction of the Corporation, the Trustee shall invest all amounts held in the Rebate Account in Eligible Investments, subject to the restrictions set forth in the Tax Certificate. Moneys shall not be transferred from the Rebate Account except as provided in paragraph (e) below. The Trustee shall not be liable for any consequences arising from such investment.

(e) Upon receipt of the Corporation's written directions, the Trustee shall remit part or all of the balances in the Rebate Account to the United States, as directed in writing by the Corporation. In addition, if the Corporation so directs, the Trustee will deposit money into or transfer money out of the Rebate Account from or into such Accounts or Funds as directed by the Corporation's written directions; provided, that only moneys in excess of the Rebate Requirement may, at the written direction of the Corporation, be transferred out of the Rebate Account to such other Accounts or Funds or to anyone other than the United States in satisfaction of the arbitrage rebate obligation. Any funds remaining in the Rebate Account after each five year remittance to the United States, redemption and payment of all of the bonds and payment and satisfaction of any Rebate Requirement, or after provision has been made therefor satisfactory to the Trustee, shall be withdrawn and deposited in the Pledged Revenues Account.

Application of Supplemental Account

In addition to the application of amounts deposited in the Supplemental Account pursuant to the Indenture, and whether or not an Event of Default shall have occurred, the Corporation shall cause amounts in the Supplemental Account to be applied, at the written direction of the State, to the defeasance, purchase (subject to any applicable maximum purchase price limitation set forth in the Act) or optional redemption of Bonds in accordance with one or more Series Supplements. Notwithstanding the requirements of the Indenture described herein under paragraph (B)(vi) under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2003B BONDS – Flow of Funds" or the preceding sentence of this paragraph to the contrary, between April 15 and the next succeeding June 1 or December 1 in each year, no amounts in the Supplemental Account shall be applied or set aside to defease Bonds or to pay the optional redemption or purchase price of Bonds unless there is held in the Debt Service Account sufficient amounts to pay all Debt Service scheduled to be paid on or before such June 1 or December 1 Distribution Date. (Section 4.10)

Contract; Obligations to Beneficiaries

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

Under the Indenture, the Corporation covenants to pay when due all sums payable on the Bonds, but only from the Pledged Revenues and money designated in the Indenture, subject only to (i) the Indenture, and (ii) 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 Swap Contracts and Ancillary Contracts. The obligation of the Corporation to pay principal or Sinking Fund Installments, interest and redemption premium, if any, to the Holders of Bonds shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment or counterclaim.

The Corporation shall pay its Operating Expenses (including, without limitation, any Bond insurance premiums payable by the Corporation on or after the Closing Date). The Corporation may borrow money to pay, and repay such borrowings as Operating Expenses. The aggregate amount of such borrowings shall never exceed the Operating Cap.

In addition, the Corporation 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 Pledged Revenues and

other collateral purported to be pledged in the manner and to the extent provided in the Indenture. The Pledged 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 the Corporation to that end has been duly and validly taken. The Bonds and the provisions of the Indenture are and will be the valid and binding obligations of the Corporation in accordance with their terms. (Section 5.01)

Enforcement

Under the Indenture, the Trustee shall enforce, by appropriate legal proceedings, each covenant, pledge or agreement made by the State in the Purchase Agreement for the benefit of any of the Beneficiaries. (Section 5.02)

Tax Covenants

The Corporation will covenant under the Indenture that:

(a) the Corporation shall at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on Tax-Exempt Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Code; and

(b) no funds of the Corporation shall at any time be used directly or indirectly to acquire securities, obligations or other investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code.

If and to the extent required by the Code, the Corporation shall periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty. Without limiting the foregoing, the Corporation agrees that it will comply with the provisions of the Tax Certificate which are incorporated in the Indenture. The Corporation's tax covenants shall, notwithstanding any other provisions of the Indenture, survive the defeasance or other payment of the Tax-Exempt Bonds. (Section 5.03)

Accounts and Reports

The Corporation will make the following covenants under the Indenture:

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

(b) annually, within 210 days after the close of each Fiscal Year, deliver to the Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants;

(c) keep in effect at all times by Officer's Certificate an accurate and current schedule of all Debt Service to be payable over the term of then Outstanding Bonds, Swap Contracts and Ancillary Contracts; certifying for the purpose such estimates as may be necessary; and

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

(1) the Outstanding Bonds of each Series;

(2) the amount of principal and Sinking Fund Installments to be paid to the Holders of the Bonds of each Series on such Distribution Date;

(3) the amount of interest to be paid to the Holders of the Bonds of each Series on such Distribution Date;

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

(5) the aggregate principal amount that has been applied to the defeasance, purchase or optional redemption of the Bonds of each Series, during the period ending on such Distribution Date and commencing on the day after the preceding Distribution Date;

(6) the Debt Service Reserve Requirement as of that Distribution Date;

(7) whether or not there have been any payments received under a Contract since the preceding Distribution Date; and

(8) the amount of Junior Payments paid or to be paid to Beneficiaries under each Swap Contract and Ancillary Contract on such Distribution Date. (Section 5.04)

Ratings

Unless otherwise specified by Series Supplement, the Corporation shall 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 one Rating Agency. (Section 5.05)

Affirmative Covenants

The Corporation will make the following affirmative covenants under the Indenture:

Punctual Payment. The Corporation shall duly and punctually pay the principal or Sinking Fund Installments of and premium, if any, and interest on the Bonds in accordance with the terms of the Bonds and the Indenture.

Maintenance of Existence. Unless the Special Conditions described under "Limitations on Consolidation, Merger, Sale of Assets, etc." below are met, the Corporation shall keep in full effect its existence, rights and franchises as a public benefit corporation of the State under the laws of the State.

Protection of Collateral. The Corporation shall from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (i) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (ii) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (iii) preserve and defend title to the Pledged Revenues and other collateral pledged under the Indenture and the rights of the Trustee and the Bondholders in such collateral against the claims of all persons and parties, including the challenge by any party to the validity or enforceability of the Consent Decree, the Indenture, the Sale Agreement or the Act or the performance by any party thereunder; (iv) cause the Trustee to enforce the Sale Agreement; (v) pay any and all taxes levied or assessed upon all or any part of the collateral; or (vi) carry out more effectively the purposes of the Indenture.

Performance of Obligations. The Corporation (i) shall diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the collateral and (ii) shall not take any action and will use its best efforts not to permit any action to be taken by others that would release 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 Sale Agreement or the Consent Decree.

Notice of Events of Default. The Corporation will give the Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture.

Concerning Payments Under Contracts. If, on the fifth Business Day preceding any Distribution Date, the sum of the amounts on deposit to the credit of the Debt Service Account, the Debt Service Reserve Account and the Supplemental Account shall be less than the Debt Service to be payable or scheduled to be payable on such Distribution Date, then the Trustee shall cause written notice thereof, and demand for payment of an amount necessary to eliminate any such deficiency, to be promptly submitted on behalf of the Corporation to the Director of the Budget of the State pursuant to the terms of the related Contract, such payment to be received (subject to the terms of the related Contract) in any event on or before such Distribution Date, and any amounts paid pursuant to such Contract shall be deposited directly to the credit of the Debt Service Account for the purposes of making payments on such Distribution date pursuant to certain sections under the Indenture. (Section 5.06)

Negative Covenants

The Corporation will make the following negative covenants under the Indenture:

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

No Setoff. The Corporation shall not claim any credit on, or make any deduction from the principal or premium, if any, or interest due in respect of, the Bonds or payments due to other Beneficiaries or assert any claim against any present or former Bondholder or Beneficiary by reason of the payment of taxes levied or assessed upon any part of the collateral.

Liquidation. Unless the Special Conditions described under "Limitations on Consolidation, Merger, Sales of Assets, etc" below are met, the Corporation shall not terminate its existence or dissolve or liquidate in whole or in part.

Limitation of Liens. The Corporation shall not (i) permit the validity or effectiveness of the Indenture or the Sale Agreement to be impaired, or permit the lien of the Indenture or the Sale Agreement 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 thereby, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture and any lien securing Permitted Indebtedness) to be created on or extend to or otherwise arise upon or burden the collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the 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, the Corporation shall not consolidate or merge with or into any other person, or convey or transfer all or substantially all of its properties or assets, unless the following conditions (the "**Special Conditions**") are met:

(a) an entity shall survive such event, and such entity shall be organized and existing under the laws of the United States, the State or any state and shall expressly assume the due and punctual payment of all obligations owing to Beneficiaries and the performance or observance of every agreement and covenant of the Corporation in the Indenture;

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

(c) the Corporation has received an opinion of Bond Counsel to the effect that such transaction will not adversely affect the exclusion of interest on any Tax-Exempt Bond from gross income for federal income tax purposes;

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

(e) the Corporation has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

No Other Business. The Corporation will not engage in any business other than financing, purchasing, owning and managing any portion of the State's Share sold by the State to the Corporation in the manner contemplated by the Indenture, the Sale Agreement and any other sale agreement with the State, and activities incidental thereto.

No Borrowing. The Corporation will not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness except Permitted Indebtedness, and in the event that the Corporation incurs indebtedness other than issuing the Bonds, the Corporation shall provide the Rating Agency written notice of such indebtedness. Swap Contracts and Ancillary Contracts are not indebtedness within the meaning of this covenant.

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

Restricted Payments. The Corporation will not, directly or indirectly, make payments to or distributions from the Pledged Revenues Account except in accordance with the Indenture. (Section 5.08)

Prior Notice

The Corporation will give each Rating Agency thirty days' prior written notice of each issue of Bonds other than the Series 2003B Bonds, with a copy of the proposed Series Supplement, and of each Supplemental Indenture, amendment to the Sale Agreement, Contingency Contract, Swap Contract, Ancillary Contract or defeasance or redemption of Bonds. (Section 5.09)

Pledged Settlement Payments

Under the Indenture, the Corporation acknowledges that the MSA, the Consent Decree and the Sale 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 State or any other person of, any such claim to the contrary.

By acknowledging that the MSA, the Consent Decree and the Sale Agreement constitute important security provisions of the Bonds, the Corporation also acknowledges under the Indenture that, in the event of any failure or refusal by the State to comply with its agreements included in the MSA, the Consent Decree or the Sale Agreement, the Holders of the Bonds may have suffered damage, 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 the Corporation will waive any right to assert any claim to the contrary and agrees that it shall neither in any manner directly or indirectly assert, nor in any manner directly or indirectly support the assertion by the State or any other person of, any claim to the effect that no such monetary damages have been suffered. (Section 6.01)

Resignation or Removal of the Trustee

Under the Indenture, the Trustee may resign at any time on not less than 30 days' written notice to the Corporation, the Holders and each of the Rating Agencies. The Trustee will promptly certify to the Corporation that

it has sent written notice to all Holders and such certificate will be conclusive evidence that such notice was mailed as required hereby. Upon receiving such notice of resignation, the Corporation shall promptly appoint a successor and, upon the acceptance by the successor of such appointment, release the resigning Trustee from its obligations under the Indenture by written instrument, a copy of which instrument shall be delivered to each of the Holders, the resigning Trustee and the successor Trustee. The Trustee may be removed by the Corporation or by a Majority in Interest of Outstanding Bonds, upon written notice to the Trustee, if the Trustee is or becomes rated below investment grade by Moody's and each successor Trustee will have an investment grade rating from Moody's. The Trustee may also be removed by written notice from the Corporation if no Default has occurred or from a Majority in Interest of the Holders of the Outstanding Bonds to the Trustee and the Corporation. No such resignation or removal will take effect until a successor has been appointed and has accepted the duties of the Trustee. (Section 7.04)

Successor Fiduciaries

Any corporation or association which succeeds to the municipal corporate trust business of a Fiduciary as a whole or substantially as a whole, whether by sale, merger, consolidation or otherwise, will become vested under the Indenture, with all the property, rights, powers and duties under the Indenture, without any further act or conveyance or without the execution or filing of any paper with any party hereto except where an instrument of transfer or assignment is required by law to effect such succession, anything in the Indenture to the contrary notwithstanding.

In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary shall with due care terminate its activities under the Indenture and a successor may, or in the case of the Trustee will, be appointed by the Corporation. The Corporation shall notify the Holders and the Rating Agencies of the appointment of a successor Trustee in writing within 20 days from the appointment. The Corporation will promptly certify to the successor Trustee that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given as required by the Indenture. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with the provisions of the Indenture summarized above under the caption "Resignation or Removal of the Trustee" or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Holder may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Trustee appointed in accordance with the provisions of the Indenture shall be a trust company or a bank having the powers of a trust company, having a capital and surplus of not less than $50,000,000 and a Moody's rating of Baa3 or higher or otherwise as approved by the Rating Agencies. Any such successor Trustee shall notify the Corporation of its acceptance of the appointment and, upon giving such notice, shall become Trustee, vested with all the property, rights, powers and duties of the Trustee under the Indenture, without any further act or conveyance. Such successor Trustee shall execute, deliver, record and file such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Trustee will from time to time execute, deliver, record and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Indenture. (Section 7.05)

Reports by Trustee to Holders

The Trustee, on or prior to each Distribution Date for a Series of Bonds, shall deliver to the Holders of such Bonds who shall have provided a written request therefor to the Trustee, and to each Rating Agency, a written statement indicating certain items described in the Indenture. The Trustee's responsibility for delivering such information is limited to availability, timeliness and accuracy of the information provided to the Trustee by the Corporation in accordance with the Indenture. (Section 7.06)

Nonpetition Covenant

Notwithstanding any prior termination of the Indenture, no Fiduciary shall, prior to the date that is one year and one day after the termination of the Indenture, acquiesce, petition or otherwise invoke or cause the Corporation to invoke the process of any court of government authority for the purpose of commencing or sustaining a case against the Corporation under any federal or state bankruptcy, insolvency or similar law or appointing a receiver,

liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Corporation or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Corporation. (Section 7.07)

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 in the Indenture) if made in the following manner, but the Corporation or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or his attorney of such instrument may be proved by the certificate or signature guarantee, which need not be acknowledged or verified, of an officer of a bank, trust company or securities dealer satisfactory to the Corporation or to the Trustee; or of any notary public or other officer authorized to take acknowledgments of deeds to be recorded in the state in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other officer. The authority of the person or persons executing any such instrument on behalf of a corporate Holder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of the owner of any Bond will be irrevocable and bind all future record and beneficial owners thereof. (Section 8.01)

Whenever by the terms of the Indenture the Holders of any percentage in principal amount of Outstanding Series 2003B Bonds may exercise any right or power, consent to an amendment, modification or waiver, or request or direct Trustee to take any action, the Insurer of particular Insured Series 2003B Bonds shall be deemed to be the Holder of such Outstanding Insured Series 2003B Bonds. (Section 3.3 of the Series 2003B Supplement).

Registered Owners

Certain provisions of the Indenture applicable to DTC as Holder of immobilized Bonds shall not be construed in limitation of the rights of the Corporation and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions in the Indenture, any payment to the registered owner of a Bond will satisfy the Corporation's obligations thereon to the extent of such payment. (Section 8.02)

Remedies

If an Event of Default occurs the Trustee may, and upon written request of the Holders of 25% in principal amount or Accreted Value of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with the law:

(i) enforce all rights of the Holders and require the Corporation or, to the extent permitted by law, the State to carry out its agreements with the Holders and to perform its duties under the Sale Agreement;

(ii) sue upon such Bonds;

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

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

In no event shall the principal of any Bond be declared due and payable in advance of its stated maturity.

The Trustee shall, in addition to the other provisions of the "Remedies" section of the Indenture, 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.

Upon a failure of the Corporation to pay when due, principal or Sinking Fund Installments of or interest on any Bond or a failure actually known to an Authorized Officer of the Trustee to make any other payment required thereby within seven days after the same becomes due and payable, the Trustee shall give written notice thereof to the Corporation and the Budget Director of the State. The Trustee shall give Default notices under certain provisions of the Indenture when instructed to do so by the written direction of another Fiduciary or the Holders of at least 25% in principal amount or Accreted Value of the Outstanding Bonds. The Trustee shall proceed for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Bonds. The Trustee shall not be required to take any remedial action (other than the giving of notice) unless indemnity satisfactory to the Trustee 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 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. The foregoing provisions of the "Remedies" section of the Indenture to the contrary notwithstanding, the remedies available to the Trustee for any breach of the pledges and assignments of the State relating to the diligent enforcement of the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA shall be limited to injunctive relief. (Section 9.02)

Waiver

If the Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Trustee may waive the Default and its consequences, by written notice to the Corporation, and shall do so upon written instruction of the Holders of at least 25% principal amount or Accreted Value of the Outstanding Bonds. (Section 9.03)

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 therein provided; and all proceedings at law or in equity to enforce any provision of the Indenture will be instituted, had and maintained in the manner provided therein and for the equal benefit of all Holders of the same class; 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 the Corporation 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 in the Bonds. (Section 9.06)

Venue

The venue of every action, suit or special proceeding against the Corporation shall be laid in the State and shall be heard and determined in the Supreme Court for the State of New York, County of Albany, and in accordance with the Act. (Section 9.07)

Supplements and Amendments to the Indenture

The Indenture may be:

(i) supplemented by delivery to the Trustee of an instrument certified by an Authorized Officer of the Corporation to (1) provide for earlier or greater deposits into the Funds and Accounts, (2) subject any property to the lien of the Indenture, (3) add to the covenants and agreements of the

Corporation or surrender or limit any right or power of the Corporation, (4) identify particular Bonds for purposes not inconsistent with the provisions of the Indenture, 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 of 1933, as amended, 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

(ii) amended in any other respect by the Corporation and the Trustee, (1) to add provisions that are not materially adverse to the Holders, or (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 provisions of subparagraph (iii) below; or

(iii) otherwise amended only with written notice to the Rating Agencies and the written consent of a Majority in Interest of the Bonds to be Outstanding and affected thereby. However, the Indenture may not be amended so as to (1) extend the maturity of any Bond, (2) reduce the principal or Sinking Fund Installment amount, applicable premium or interest rate of any Bond, (3) make any Bond redeemable other than in accordance with its terms, (4) create a preference or priority of any Bond over any other Bond of the same class, or (5) reduce the percentage of the Bonds required to be represented by the Holders giving their consent to any amendment, unless the Holders of the Bonds affected by such amendment have consented to it in writing.

Any amendment of the Indenture shall be accompanied by a Bond Counsel's opinion addressed to the Trustee 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 the Corporation determines that the requisite number of consents have been obtained for an amendment to the Indenture which requires consents, it shall file a certificate to that effect in its records and give written notice to the Trustee and the Holders. The Trustee will promptly certify to the Corporation that it has given such notice to all Holders and such certificate will be conclusive evidence that such notice was given in the manner required by the Indenture. (Section 10.01)

Supplements and Amendments to the Sale Agreement

The Sale Agreement may be amended in accordance with the provisions of Section 6.01 thereof, with the consent of the Trustee but without the consent of the Holders of the Bonds (i) to cure any ambiguity, (ii) to correct or supplement any provisions in the Sale Agreement, (iii) to correct or amplify the description of the tobacco settlement payments sold thereunder, (iv) to add additional covenants for the benefit of the Corporation, or (v) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that shall not, adversely affect in any material respect the interest of the Holders of Outstanding Bonds. The Sale Agreement may also be amended from time to time by the Corporation and the State, with the consent of a Majority in Interest of the Bondholders, for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sale Agreement or of modifying in any manner the rights of the Bondholders, but no such amendment shall reduce the aforesaid portion of the Outstanding amount of the Bonds, the Holders of which are required to consent to any such amendment, without the consent of all of the Bondholders. In the event that the Trustee receives a request for a consent or other action under the Sale Agreement, the Trustee may, and if consent or other action by Holders is required shall, transmit a notice of such request to each Holder and request directions with respect thereto; and the Trustee (and the Corporation, if applicable) shall proceed in accordance with such directions (if any), pursuant to the Indenture and the Sale Agreement. (Section 10.02)

Supplements and Amendments to Contracts

A Contract may be amended, changed, modified or altered, with the consent of the Trustee but without the consent of Bondholders, (i) to cure any ambiguity, or to correct or supplement any provisions contained in the Contract that may be defective or inconsistent with any other provisions contained in the Indenture or in such Contract, and (ii) in any other manner that does not materially adversely affect the interest of the Holders of Outstanding Bonds. With the prior written consent of a Majority in Interest of the Bonds then Outstanding, a Contract may also be amended, changed, modified, altered or terminated, provided however, that no such amendment, change, modification, alteration or termination will reduce the percentage of the aggregate principal amount of Outstanding Bonds the consent of the Holders of which is a requirement for any such amendment, change, modification, alteration or termination, or, without the consent of the Bondowners adversely affected thereby, decrease the amount of any payment to be made under any Contract or extend the time allowed for payment thereof; and provided, further, that if such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified series remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds for purposes of the Indenture. No amendment to a Contract shall become effective until an executed copy thereof certified by an Authorized Officer of the Corporation shall be filed with the Trustee. (Section 10.03)

THE SALE AGREEMENT

The following summary describes certain terms of the Sale 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 Sale Agreement.

Conveyance of the Portion of the State's Share

On the Closing Date, the State will sell and convey to the Corporation without recourse (subject to certain continuing obligations set forth in the Sale Agreement) in accordance with and subject to the terms of the Sale Agreement, all of its right, title and interest in and to the Portion of the State's Share. As consideration for such sale and conveyance of the Portion of the State's Share, the Corporation promises to pay and otherwise convey to the State, without recourse, on the Closing Date, the proceeds (net of Financing Costs) of the Series 2003B Bonds and the Residual Certificate in accordance with and subject to the terms and conditions of the Indenture.

The right of the Corporation to receive the Pledged Settlement Payments, on and after the Closing Date, is valid and enforceable, and, during the respective periods that Pledged Settlement Payments are payable to the Corporation and pledged under the Indenture, the right of the Corporation to receive the Pledged Settlement Payments is equal to and on a parity with, and is not inferior or superior to the right and the claim of the Series 2003A Trustee to receive the Previously Purchased and Pledged Settlement Payments. Neither the Corporation nor any Beneficiary, person or entity shall have the right to make a claim to make up all or any portion of a perceived deficiency in Pledged Settlement Payments from the Previously Purchased and Pledged Settlement Payments and, likewise, neither the Corporation nor the Series 2003A Trustee shall have any right to make a claim to make up all or any portion of a perceived deficiency in the Previously Purchased and Pledged Settlement Payments from the Pledged Settlement Payments. (Section 2.01)

Representations of State

The State makes the following representations on which the Corporation is deemed to have relied in acquiring the Portion of the State's Share. The representations speak as of the Closing Date, and survive the sale of the Portion of the State's Share and the pledge thereof to the Trustee as Pledged Settlement Payments pursuant to the Indenture.

Power and Authority. The State is duly authorized through the Act to sell the Portion of the State's Share and has full power and authority to execute and deliver the Sale Agreement and to carry out its terms.

Binding Obligation. The Sale Agreement has been duly executed and delivered by the State and, assuming the due authorization, execution and delivery of the Sale Agreement by the Corporation, constitutes a legal, valid and binding obligation of the State 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 Sale Agreement, except for those which have been obtained and are in full force and effect.

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

No Proceedings. To the State's knowledge, and except as may be described in a written certificate of the Attorney General on the Closing Date or as may be disclosed in this Official Statement, there are no proceedings pending against the State, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State: (1) asserting the invalidity of any of the Transaction Documents or the Series 2003B Bonds, (2) seeking to prevent the issuance of the Series 2003B Bonds or the consummation of any of the transactions contemplated by any of the Transaction Documents, or (3) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of any of the Act, the Consent Decree, the MSA, the Qualifying Statute, the Complementary Legislation, the Transaction Documents, or the Series 2003B Bonds.

Title to Portion of the State's Share. The State is the sole owner of the Portion of the State's Share to be sold to the Corporation under the Sale Agreement. On and after the Closing Date, (1) the State shall have no right, title or interest in or to the Portion of the State's Share, and (2) the Portion of the State's Share shall be the property of the Corporation, and not of the State, and shall be owned, received, held and disbursed by the Corporation or the Trustee and not by the State. Pursuant to the Act and the Sale Agreement, (1) the Pledged Settlement Payments shall be paid directly to the Trustee, and (2) the Pledged Settlement Payments shall not be received by the State.

True Sale; Absence of Liens on Portion of the State's Share. The State is irrevocably selling the Portion of the State's Share free and clear of any and all State Liens, pledges, charges, security interests or any other statutory impediments to transfer or conveyance of any nature encumbering the Portion of the State's Share. The sale of the Portion of the State's Share is, and shall be treated as, a true sale and absolute transfer and conveyance of the property, and all of the right, title and interest in and to such property, so transferred and conveyed, and not as a pledge or any other security interest granted by the State for any borrowing. The characterization by the State of such sale as an absolute transfer or conveyance will not be negated or adversely affected by (1) the sale and assignment pursuant to the Sale Agreement of less than all of the State's Share, (2) the issuance and delivery to the State of the Residual Certificate, (3) any characterization of the Corporation or its bonds for purposes of accounting, taxation or securities regulation, (4) or by the pledge of other funds or assets of the Corporation, including the Contract and the revenues provided by the State and pledged by the Corporation thereunder, or (5) any other factor whatsoever.

Assignment to the Trustee. The State acknowledges and consents to the pledge, assignment and grant of a security interest by the Corporation to the Trustee pursuant to the Indenture for the benefit of the Bondholders and certain other Beneficiaries, of any or all right, title and interest of the Corporation in, to and under the Pledged Settlement Payments. The State acknowledges that the Corporation will assign to the Trustee for the benefit of the Bondholders and certain other Beneficiaries, all of its rights and remedies with respect to any breach by the State of any of its obligations, representations and warranties under the Sale Agreement, subject, however, to the limitations and provisions set forth in the following paragraph.

The State's acknowledgments and consents in the foregoing paragraph are subject to the condition that any and all pledges, assignments and grants made or to be made by the Corporation pursuant to the foregoing paragraph

shall be limited solely to the Trustee for the benefit of Bondholders and certain other Beneficiaries. The Corporation agrees that any pledge, assignment and grant it makes in accordance therewith will be limited and restricted so that the Trustee may not further assign any such rights, remedies and interest to any other person or entity, including any different or additional assignment thereof to Bondholders or certain other Beneficiaries.

Redemption of Bonds at Direction of State. The Corporation grants, assigns and conveys to the State the independent right (in addition to the rights retained by the Corporation under the Indenture), but not any obligation, to exercise the right of the Corporation to cause the optional redemption of the Bonds in accordance with the requirements of the Indenture, from either the Supplemental Account (as defined under the Indenture) in which funds are available therefor under the Indenture or upon the State providing the funds necessary therefor. The State Representative shall file a certificate with the Corporation and Trustee on or before each Distribution Date in the event the State elects to exercise such right with respect to the Supplemental Account on such Distribution Date, and the State Representative shall file a certificate with the Corporation and Trustee at least 30 days before a Distribution Date in the event the State elects to exercise such right with respect to funds other than Supplemental Account on such Distribution Date. The Corporation shall not exercise any right of the Corporation under the Indenture to cause the optional redemption of the Bonds except upon direction of the State Representative. (Section 3.01)

Limitation on Liability

Neither the State nor any person holding a position by election, appointment or employment in the service of the State, any member of the Corporation, or any officer, employee, or agent of the Corporation, while acting within the scope of their authority, shall be subject to any personal liability resulting from exercising or carrying out of any of the State's or the Corporation's purposes or powers.

Members, officers, and employees and agents of the Corporation under the Sale Agreement shall be subject to the provisions of section 17 of the Public Officer's Law of the State. (Section 3.02)

Pledges; Protection of Title; Non-Impairment Covenant

The State covenants and agrees with the Corporation, and the Corporation is authorized to include such covenant and agreement in the Indenture for the benefit of the Beneficiaries, that the State will (i) irrevocably direct, through the Attorney General, the independent auditor and the escrow agent under the MSA to transfer all Pledged Settlement Payments directly to the Trustee, (ii) enforce, at the expense of the State, its right to collect all monies due from the PMs under the MSA, (iii) diligently enforce, at the expense of the State, the Qualifying Statute as contemplated in section IX(d)(2)(B) of the MSA against all tobacco product manufacturers selling tobacco products in the State that are not in compliance with the Qualifying Statute, in each case in the manner and to the extent deemed necessary in the judgment of the Attorney General, provided, however, as stated in the Sale Agreement, (a) that the remedies available to the Corporation and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (iii) shall be limited to injunctive relief, and (b) that the State shall be deemed to have diligently enforced the Qualifying Statute so long as there has been no judicial determination by a court of competent jurisdiction in the State, in an action commenced by a PM under the MSA, that the State has failed to diligently enforce the Qualifying Statute for the purposes of section IX(d)(2)(B) of the MSA, (iv) neither amend the MSA nor the Consent Decree or take any other action in any way that would materially adversely (a) alter, limit or impair the Corporation's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested by the Act in the Corporation to fulfill the terms of its agreements with the Bondholders, or (c) in any way impair the rights and remedies of the 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 proceedings by or on behalf of the Bondholders, are fully paid and discharged (provided, that nothing in this clause (iv) or elsewhere in the Sale Agreement or the Act shall be construed to preclude the State's regulation of smoking and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify, repeal or otherwise alter statutes imposing or relating to the taxes), and (v) not amend, supersede or repeal the Qualifying Statute and the Complementary Legislation in any way that would materially adversely affect the amount of any payment to, or materially adversely affect the rights of, the Corporation or the Bondholders. Notwithstanding these pledges and agreements by the State, the Attorney General may in his or her discretion enforce any and all provisions of the MSA without limitation.

In accordance with the Act, prior to the date that is one year and one day after which the Corporation no longer has any Bonds Outstanding, the Corporation is prohibited from filing a voluntary petition under Chapter 9 of the Bankruptcy Code or such corresponding chapter or section as may, from time to time, be in effect, and a public official or organization, entity, or other person shall not authorize the Corporation to be or become a debtor under Chapter 9 or any successor or corresponding chapter or sections during such period. In accordance with the Act, this contractual obligation will be part of the contractual obligation owed to Bondholders and may not subsequently be modified by State law prior to the date that is one year and one day after which the Corporation no longer has any Bonds Outstanding.

Upon request of the Corporation or the Trustee, the State will execute and deliver such further instruments and do such further acts as the parties reasonably agree are reasonably necessary or proper to carry out more effectively the purposes of the Sale Agreement. (Section 4.01)

Tax Covenants

Pursuant to section 4 of the Act, the State agrees as follows:

The State will at all times do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid by the Corporation on the Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

The State will not directly or indirectly use or permit the use of any of the proceeds of the Bonds that would cause the Bonds to be "private activity bonds" within the meaning of Section 141(a) of the Tax Code or would cause interest on the Bonds to not be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Tax Code.

The State agrees that no gross proceeds (as such term is defined in Section 1.148-1 of the Treasury Regulations promulgated under Section 148 of the Tax Code, as such Treasury Regulations and the Tax Code may be amended from time to time) of the Bonds shall at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any Bond to be an "arbitrage bond" as defined in the Tax Code and any applicable Treasury Regulations promulgated thereunder.

The State will execute a tax certificate containing all appropriate representations, covenants, statements of intention and certifications of fact and reasonable expectations for bond counsel to the Corporation to render its opinion that interest on the Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code. (Section 4.02)

Residual Certificate and Previously Purchased and Pledged Settlement Payments

The Corporation shall determine the amounts of the residual interests represented by the Residual Certificate, and pay and transfer such residual interests to the registered owner of the Residual Certificate. To the extent that the Trustee shall receive an amount not constituting Pledged Settlement Payments or any Unsold Settlement Payments or Previously Purchased and Pledged Settlement Payments, the Corporation shall cause the Trustee to promptly remit such amount to or upon the order of the State or of the Series 2003A Trustee, as applicable. (Section 5.02)

Bonds Not Debt of State

The Bonds must be issued in the name of the Corporation. The Bonds will be obligations only of the Corporation, payable solely from the special fund or funds created by the Corporation and pledged for their payment. The Bonds and any Ancillary Bond Facility must contain a recital on their face to the effect that, pursuant to the Act, neither any Bond nor any Ancillary Bond Facility shall constitute a debt or moral obligation of the State or a State supported obligation within the meaning of any constitutional or statutory provision or a pledge of the faith and credit of the State or the taxing power of the State, and the State shall not be liable to make any payments thereon nor shall any Bond or Ancillary Bond Facility be payable out of any funds or assets other than Pledged

Settlement Payments and other assets if any, sold to the Corporation and other funds and assets of or available to the Corporation including those received from the State under the Contract and pledged therefor under the Indenture. (Section 5.03)

Amendment

Except as otherwise provided in the third paragraph under the caption "Pledges; Protection of Title; Non-Impairment Covenant" above, after issuance of the Series 2003B Bonds, the Sale Agreement may be amended by agreement of the State and the Corporation, with the consent of the Trustee but without the consent of any of the Bondholders: (1) to cure any ambiguity; (2) to correct or supplement any provisions in the Sale Agreement; (3) to correct or amplify the description of the Portion of the State's Share; (4) to add additional covenants for the benefit of the Corporation; or (5) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that shall not adversely affect in any material respect the Bonds.

In addition to the provisions in the preceding paragraph, the Sale Agreement may also be amended from time to time by the Corporation and the State, with the consent of a majority of the Bondholders for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sale Agreement or of modifying in any manner the rights of the Bondholders, but no such amendment may reduce the aforesaid portion of the Outstanding amount of the Bonds, the Holders of which are required to consent to any such amendment, without the consent of all of the Bondholders.

Prior to the execution of any amendment to the Sale Agreement, the Trustee will be entitled to receive and rely upon an Opinion of Counsel stating that the execution of such amendment is authorized or permitted by the Sale Agreement and will not adversely affect the exclusion of interest on any tax-exempt Bonds from gross income for federal income tax purposes. Without the prior written consent of the Trustee, no amendment, supplement or other modification of the Sale Agreement may be entered into or be effective. (Section 6.01)

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APPENDIX H

SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY OF XL CAPITAL ASSURANCE INC.

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XL CAPITAL ASSURANCE

1221 Avenue of the Americas
New York, New York 10020
Telephone: (212) 478-3400

MUNICIPAL BOND INSURANCE POLICY

ISSUER: [ ]

Policy No: [ ]

BONDS: [ ]

Effective Date: [ ]

XL Capital Assurance Inc. (XLCA), a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy (which includes each endorsement attached hereto), hereby agrees unconditionally and irrevocably to pay to the trustee (the "Trustee") or the paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the benefit of the Owners of the Bonds or, at the election of XLCA, to each Owner, that portion of the principal and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment.

XLCA will pay such amounts to or for the benefit of the Owners on the later of the day on which such principal and interest becomes Due for Payment or one (1) Business Day following the Business Day on which XLCA shall have received Notice of Nonpayment (provided that Notice will be deemed received on a given Business Day if it is received prior to 10:00 a.m. New York time on such Business Day; otherwise it will be deemed received on the next Business Day), but only upon receipt by XLCA, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in XLCA. Upon such disbursement, XLCA shall become the owner of the Bond, any appurtenant coupon to the Bond or the right to receipt of payment of principal and interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by XLCA hereunder. Payment by XLCA to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of XLCA under this Policy.

In the event the Trustee or Paying Agent has notice that any payment of principal or interest on a Bond which has become Due for Payment and which is made to an Owner by or on behalf of the Issuer of the Bonds has been recovered from the Owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law, such Owner will be entitled to payment from XLCA to the extent of such recovery if sufficient funds are not otherwise available.

The following terms shall have the meanings specified for all purposes of this Policy, except to the extent such terms are expressly modified by an endorsement to this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment", when referring to the principal of Bonds, is when the stated maturity date or a mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity, unless XLCA shall elect, in its sole discretion, to pay such principal due upon such acceleration; and, when referring to interest on the Bonds, is when the stated date for payment of interest has been reached. "Nonpayment" means the failure of the Issuer to have provided sufficient funds to the Trustee or Paying Agent for payment in full of all principal and interest on the Bonds which are Due for Payment. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to XLCA which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

XLCA may, by giving written notice to the Trustee and the Paying Agent, appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy. From and after the date of receipt by the Trustee and the Paying Agent of such notice, which shall specify the name and notice address of the Insurer's Fiscal Agent, (a) copies of all notices required to be delivered to XLCA pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to XCLA and shall not be deemed received until received by both and (b) all payments required to be made by XLCA under this Policy may be made directly by XLCA or by the Insurer's Fiscal Agent on behalf of XLCA. The Insurer's Fiscal Agent is the agent of XLCA only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of XLCA to deposit or cause to be deposited sufficient funds to make payments due hereunder.

Except to the extent expressly modified by an endorsement hereto, (a) this Policy is non-cancelable by XLCA, and (b) the Premium on this Policy is not refundable for any reason. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Bond, other than at the sole option of XLCA, nor against any risk other than Nonpayment. This Policy sets forth the full undertaking of XLCA and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto.

THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, XLCA has caused this Policy to be executed on its behalf by its duly authorized officers.

Name:	Name:
Title:	Title:

APPENDIX I

SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY OF CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.

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CDC IXIS Financial Guaranty North America, Inc.
825 Third Avenue, Sixth Floor
New York, NY 10022
For information, contact (212) 909-3939
Toll-free (866) 243-4212

FINANCIAL GUARANTY INSURANCE POLICY

ISSUER: Policy No.: CIFGNA-#
CUSIP: Effective Date:
OBLIGATIONS:

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. ("CIFGNA"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY GUARANTEES to each Policyholder, subject only to the terms and conditions of this Policy (which includes each endorsement hereto), the full and complete payment by or on behalf of the Issuer of Regular Payments of principal of and interest on the Obligations.

For the further protection of each Policyholder, CIFGNA irrevocably and unconditionally guarantees:

(1) payment of any amount required to be paid under this Policy by CIFGNA following CIFGNA's receipt of notice and instruments of assignment as described in Endorsement No. 1 hereto and

(2) payment of the amount of any distribution of principal of and interest on the Obligations made during the Term of this Policy to such Policyholder that is subsequently avoided in whole or in part as a preference payment under applicable law (such payment to be made by CIFGNA in accordance with Endorsement No. 1 hereto).

CIFGNA shall be subrogated to the rights of each Policyholder to receive payments under the Obligations to the extent of any payment by CIFGNA hereunder. Upon disbursement in respect of an Obligation, CIFGNA shall become the owner of the Obligation, appurtenant coupon, if any, and all rights to payment of principal thereof or interest thereon.

The following terms shall have the meanings specified below, subject to and including any modifications set forth in any endorsement hereto, for all purposes of this Policy. "Policyholder" means, if the Obligations are in book-entry form, the registered owner of any Obligation as indicated on the registration books maintained by or on behalf of the Issuer for such purpose or, if the Obligations are in bearer form, the holder of any Obligation; *provided, however, that* any trustee acting on behalf of and for the benefit of such registered owner or holder shall be deemed to be the Policyholder to the extent of such trustee's authority. "Regular Payments" means payments of interest and principal which are agreed to be made during the Term of this Policy in accordance with the original terms of the Obligations when issued and without regard to any amendment or modification of such Obligations thereafter; payments which become due on an accelerated basis as a result of (a) a default by the Issuer or any other person, (b) an election by the Issuer to pay principal or other amounts on an accelerated basis or (c) any other cause, shall not constitute "Regular Payments" unless CIFGNA shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration. "Term of this Policy" shall have the meaning set forth in Endorsement No. 1 hereto.

This Policy sets forth in full the undertaking of CIFGNA, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto or to the Obligations, except a contemporaneous or subsequent agreement or instrument given by CIFGNA or to which CIFGNA has given its written consent, or by the merger, consolidation or dissolution of the Issuer. The premiums paid in respect of this Policy are nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Obligations prior to maturity. This Policy may not be cancelled or revoked during the Term of this Policy, including for nonpayment of premium due to CIFGNA. Payments under this Policy may not be accelerated except at the sole option of CIFGNA.

In witness whereof, CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

CDC IXIS FINANCIAL GUARANTY NORTH AMERICA, INC.

By _____

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APPENDIX J

DESCRIPTION OF AUCTION RATE PROCEDURES

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APPENDIX J

DESCRIPTION OF AUCTION RATE PROCEDURES

The following sections contain definitions of certain terms used in this Official Statement and this APPENDIX J. Capitalized terms not otherwise defined in this Official Statement have the meanings set forth in the Indenture.

Unless the context otherwise indicates, references in this APPENDIX J to the "Auction Rate Bonds" apply to each subseries of the Auction Rate Bonds independently. Actions may be taken, or determinations made, with respect to one subseries that are not taken or made with respect to the other.

Definitions

Agent Member means a member of, or participant in, the Securities Depository who shall act on behalf of a Bidder.

All Hold Rate means, as of any Auction Date, with respect to Auction Rate Bonds of a subseries, 75% of the Index in effect on such Auction Date.

Auction means each periodic implementation of the Auction Procedures.

Auction Agent means the Auctioneer appointed in accordance with the Indenture.

Auction Agreement means an agreement between the Auction Agent and the Trustee pursuant to which the Auction Agent agrees to follow the procedures specified in this APPENDIX J, with respect to the Auction Rate Bonds of a subseries in an Auction Rate Mode, as such agreement may from time to time be amended or supplemented.

Auction Date means:

(a) if the Auction Rate Bonds of a subseries are in a daily Auction Period, each Business Day; and

(b) if the Auction Rate Bonds of a subseries are in any other Auction Period, the last Business Day of such Auction Period if it is followed by another Auction Period.

On the Business Day preceding the conversion from a daily Auction Period to another Auction Period, there shall be two Auctions, one for the last daily Auction Period and one for the first Auction Period following the conversion.

Auction Period means:

(a) a Special Auction Period;

(b) with respect to Auction Rate Bonds of a subseries in a daily Auction Period, a period beginning on each Business Day and extending to but not including the next succeeding Business Day;

(c) with respect to Auction Rate Bonds of a subseries in a seven day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally seven days beginning on a Monday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally seven days beginning on a Tuesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally seven

days beginning on a Wednesday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally seven days beginning on a Thursday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally seven days beginning on a Friday (or the day following the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(d) with respect to Auction Rate Bonds of a subseries in a 28-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 28 days beginning on a Monday (or the last day of the prior Auction Period if the prior Auction Period does not end on a Sunday) and ending on the fourth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 28 days beginning on a Tuesday (or the last day of the prior Auction Period if the prior Auction Period does not end on a Monday) and ending on the fourth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 28 days beginning on a Wednesday (or the last day of the prior Auction Period if the prior Auction Period does not end on a Tuesday) and ending on the fourth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 28 days beginning on a Thursday (or the last day of the prior Auction Period if the prior Auction Period does not end on a Wednesday) and ending on the fourth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 28 days beginning on a Friday (or the last day of the prior Auction Period if the prior Auction Period does not end on a Thursday) and ending on the fourth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(e) with respect to Auction Rate Bonds of a subseries in a 35-day Auction Period and with Auctions generally conducted on (i) Fridays, a period of generally 35 days beginning on a Monday (or the last day of the prior Auction Period if the prior Auction Period does not end on Sunday) and ending on the fifth Sunday thereafter (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) Mondays, a period of generally 35 days beginning on a Tuesday (or the last day of the prior Auction Period if the prior Auction Period does not end on Monday) and ending on the fifth Monday thereafter (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iii) Tuesdays, a period of generally 35 days beginning on a Wednesday (or the last day of the prior Auction Period if the prior Auction Period does not end on Tuesday) and ending on the fifth Tuesday thereafter (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (iv) Wednesdays, a period of generally 35 days beginning on a Thursday (or the last day of the prior Auction Period if the prior Auction Period does not end on Wednesday) and ending on the fifth Wednesday thereafter (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), and (v) Thursdays, a period of generally 35 days beginning on a Friday (or the last day of the prior Auction Period if the prior Auction Period does not end on Thursday) and ending on the fifth Thursday thereafter (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day);

(f) with respect to Auction Rate Bonds of a subseries in a three-month Auction Period, a period of generally three months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the first day of the month that is the third calendar month following the beginning date of such Auction Period (unless such first day of the month is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day); and

(g) with respect to Auction Rate Bonds of a subseries in a six-month Auction Period, a period of generally six months (or shorter period upon a conversion from another Auction Period) beginning on the day following the last day of the prior Auction Period and ending on the next succeeding May 30 or November 30;

provided, however, that

(a) if there is a conversion of Auction Rate Bonds of a subseries with Auctions generally conducted on Fridays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the next succeeding Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on Sunday (unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(b) if there is a conversion of Auction Rate Bonds of a subseries with Auctions generally conducted on Mondays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the next succeeding Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on Monday (unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(c) if there is a conversion of Auction Rate Bonds of a subseries with Auctions generally conducted on Tuesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the next succeeding Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 2 1 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on Tuesday (unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

(d) if there is a conversion of Auction Rate Bonds of a subseries with Auctions generally conducted on Wednesdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the next succeeding Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 21 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on Wednesday (unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion; and

(e) if there is a conversion of Auction Rate Bonds of a subseries with Auctions generally conducted on Thursdays (i) from a daily Auction Period to a seven-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the next succeeding Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day), (ii) from a daily Auction Period to a 28-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on the Thursday (unless such Thursday is not followed by a Business Day, in which case on the next

succeeding day which is followed by a Business Day) which is more than 2 1 days but not more than 28 days from such date of conversion, and (iii) from a daily Auction Period to a 35-day Auction Period, the next Auction Period shall begin on the date of the conversion and shall end on Thursday (unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day) which is more than 28 days but no more than 35 days from such date of conversion;

provided further, however, that any Auction Period that is greater than 35 days may be extended as described in paragraph (d) in the section entitled "Determination of Auction Period Rate" in this APPENDIX J.

Auction Period Rate means with respect to Auction Rate Bonds of each subseries, the rate of interest to be borne by the Auction Rate Bonds of such subseries during each Auction Period determined in accordance with the section entitled "Determination of Auction Period Rate" in this APPENDIX J; provided, however, in no event may the Auction Rate exceed the Maximum Rate.

Auction Procedures means the procedures for conducting Auctions for Auction Rate Bonds of a subseries in an Auction Rate Mode set forth in this APPENDIX J.

Auction Rate means for each subseries of Auction Rate Bonds for each Auction Period, (i) if Sufficient Clearing Bids exist, the Winning Bid Rate; provided, however, if all of such Auction Rate Bonds of a subseries are the subject of Submitted Hold Orders, the All Hold Rate with respect to such Auction Rate Bonds and (ii) if Sufficient Clearing Bids do not exist, the Maximum Rate with respect to such Auction Rate Bonds.

Auction Rate Mode means the mode during which the Auction Rate Bonds are in an Auction Period bearing interest at an Auction Rate.

Authorized Denominations means $25,000 and integral multiples thereof while the Auction Rate Bonds bear interest at an Auction Rate.

Available Bonds means for each subseries of Auction Rate Bonds on each Auction Date, the aggregate principal amount of such Auction Rate Bonds that are not the subject of Submitted Hold Orders.

Bid has the meaning specified in subsection (a) of "Orders by Existing Owners and Potential Owners" of this APPENDIX J.

Bidder means each Existing Owner and Potential Owner who places an Order.

Broker-Dealer means, with respect to the Auction Rate Bonds of a subseries, (i) any entity that is specified as the Broker-Dealer for the Auction Rate Bonds of such subseries on the outside cover page of this Official Statement, and (ii) any entity that is permitted by law to perform the function required of a Broker-Dealer described in this APPENDIX J that is a member of, or a direct participant in, the Securities Depository, that has been selected by the Corporation, and that is a party to a Broker-Dealer Agreement with the Auction Agent.

Broker-Dealer Agreement means collectively, each agreement between the Auction Agent and a Broker-Dealer pursuant to which such Broker-Dealer agrees to follow the procedures described in this APPENDIX J as each such agreement may from to time be amended or supplemented.

Distribution Date means each June 1 and December 1, commencing December 1, 2003, or if such date is not a Business Day, the next succeeding Business Day (but only for interest accrued through the preceding last day of May or November, as the case may be).

Existing Owner means a Person who is listed as the beneficial owner of Auction Rate Bonds of a subseries in the records of the Auction Agent.

Favorable Opinion of Bond Counsel means an opinion of counsel of recognized national standing in the field of law relating to municipal bonds and the exemption from federal income taxation of interest thereon to the

effect that an action being taken (i) is authorized by the Act and the Indenture, as supplemented, and (ii) will not adversely affect the exclusion from gross income for federal income tax purposes of interest on the Bonds.

Fitch means Fitch, Inc.

Fixed Rate Mode means the mode after which the Auction Rate Bonds have been converted to bear interest at a fixed rate.

Hold Order has the meaning specified in subsection (a) of the section entitled "Orders by Existing Owners and Potential Owners" in this APPENDIX J.

Index shall have the meaning specified in the section entitled "Index" in this APPENDIX J.

Maximum Rate means the lesser of fifteen percent (15%) or the maximum rate permitted by law.

Mode means the Auction Rate Mode or the Fixed Rate Mode.

Order means a Hold Order, Bid or Sell Order.

Potential Owner means any Person, including any Existing Owner, who may be interested in acquiring a beneficial interest in the Auction Rate Bonds of a subseries in addition to the Auction Rate Bonds currently owned by such Person, if any.

Principal Office means, with respect to the Auction Agent, the office thereof designated in the Auction Agreement as the office of the Auction Agent to which notices, requests or communications should be sent.

Securities Depository means The Depository Trust Company and its successors and assigns or any other securities depository selected by the Corporation which agrees to follow the procedures required to be followed by such securities depository in connection with the Auction Rate Bonds of a subseries.

Sell Order has the meaning specified in subsection (a) of "Orders by Existing Owners and Potential Owners" of this APPENDIX J.

Special Auction Period means any period of more than seven but less than 1,092 days which is not another Auction Period and which begins on the day immediately following the prior Auction Period and ends (i) in the case of Auction Rate Bonds of a subseries with Auctions generally conducted on Fridays, on a Sunday unless such Sunday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (ii) in the case of Auction Rate Bonds of a subseries with Auctions generally conducted on Mondays, on a Monday unless such Monday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iii) in the case of Auction Rate Bonds of a subseries with Auctions generally conducted on Tuesdays, on a Tuesday unless such Tuesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, (iv) in the case of Auction Rate Bonds of a subseries with Auctions generally conducted on Wednesdays, on a Wednesday unless such Wednesday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day, and (v) in the case of Auction Rate Bonds of a subseries with Auctions generally conducted on Thursdays, on a Thursday unless such Thursday is not followed by a Business Day, in which case on the next succeeding day which is followed by a Business Day.

S&P means Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc.

Submission Deadline means 1:00 p.m., New York City time, on each Auction Date for Auction Rate Bonds of a subseries not in a daily Auction Period and 11:00 a.m., New York City time, on each Auction Date for Auction Rate Bonds of a subseries in a daily Auction Period, or such other time on such date as shall be specified from time to time by the Auction Agent pursuant to the Auction Agreement as the time by which Broker-Dealers are required to submit Orders to the Auction Agent.

Submitted Bid has the meaning specified in subsection (b) of "Determination of Auction Period Rate" of this APPENDIX J.

Submitted Hold Order has the meaning specified in subsection (b) of "Determination of Auction Period Rate" of this APPENDIX J.

Submitted Order has the meaning specified in subsection (b) of "Determination of Auction Period Rate" of this APPENDIX J.

Submitted Sell Order has the meaning specified in subsection (b) of "Determination of Auction Period Rate" of this APPENDIX J.

Sufficient Clearing Bids means with respect to Auction Rate Bonds of a subseries, an Auction for which the aggregate principal amount of Auction Rate Bonds of such subseries that are the subject of Submitted Bids by Potential Owners specifying one or more rates not higher than the Maximum Rate is not less than the aggregate principal amount of Auction Rate Bonds of such subseries that are the subject of Submitted Sell Orders and of Submitted Bids by Existing Owners specifying rates higher than the Maximum Rate.

Winning Bid Rate means with respect to Auction Rate Bonds of a subseries the lowest rate specified in any Submitted Bid for such subseries which if selected by the Auction Agent as the Auction Period Rate would cause the aggregate principal amount of Auction Rate Bonds of such subseries that are the subject of Submitted Bids specifying a rate not greater than such rate to be not less than the aggregate principal amount of Available Bonds of such series.

Orders by Existing Owners and Potential Owners

(a) Prior to the Submission Deadline on each Auction Date:

(i) each Existing Owner may submit to a Broker-Dealer, in writing or by such other method as shall be reasonably acceptable to such Broker-Dealer, information as to:

(A) the principal amount of Auction Rate Bonds of a subseries, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period without regard to the rate determined by the Auction Procedures for such Auction Period,

(B) the principal amount of Auction Rate Bonds of a subseries, if any, held by such Existing Owner which such Existing Owner irrevocably commits to continue to hold for the next succeeding Auction Period if the rate determined by the Auction Procedures for such Auction Period shall not be less than the rate per annum then specified by such Existing Owner (and which such Existing Owner irrevocably offers to sell on such Auction Date (or the same day in the case of a daily Auction Period) if the rate determined by the Auction Procedures for the next succeeding Auction Period shall be less than the rate per annum then specified by such Existing Owner), and/or

(C) the principal amount of Auction Rate Bonds of a subseries, if any, held by such Existing Owner which such Existing Owner irrevocably offers to sell on such Auction Date (or on the same day in the case of a daily Auction Period) without regard to the rate determined by the Auction Procedures for the next succeeding Auction Period: and

(ii) for the purpose of implementing the Auctions and thereby to achieve the lowest possible interest rate on the Auction Rate Bonds of a subseries, the Broker-Dealers shall contact Potential Owners, including Persons that are Existing Owners, to determine the principal amount of Auction Rate Bonds of a subseries, if any, which each such Potential Owner irrevocably offers to purchase if the rate determined by the Auction Procedures for the next succeeding Auction Period is not less than the rate per annum then specified by such Potential Owner.

For the purposes hereof, an Order containing the information referred to in clause (i) (A) above is herein referred to as a "Hold Order," an Order containing the information referred to in clause (i) (B) or (ii) above is herein referred to as a "Bid," and an Order containing the information referred to in clause (i) (C) above is herein referred to as a "Sell Order."

(b) (i) A Bid by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of Auction Rate Bonds of a subseries specified in such Bid if the rate determined by the Auction Procedures on such Auction Date shall be less than the rate specified therein; or

(B) such principal amount or a lesser principal amount of Auction Rate Bonds of a subseries to be determined as described in subsection (a)(v) of "Allocation of Auction Rate Bonds of a Subseries" hereof if the rate determined by the Auction Procedures on such Auction Date shall be equal to such specified rate; or

(C) a lesser principal amount of Auction Rate Bonds of a subseries to be determined as described in subsection (b)(iv) of "Allocation of Auction Rate Bonds of a Subseries" hereof if such specified rate shall be higher than the Maximum Rate and Sufficient Clearing Bids do not exist.

(ii) A Sell Order by an Existing Owner shall constitute an irrevocable offer to sell:

(A) the principal amount of Auction Rate Bonds of a subseries specified in such Sell Order; or

(B) such principal amount or a lesser principal amount of Auction Rate Bonds of a subseries as described in subsection (b)(iv) of "Allocation of Auction Rate Bonds of a Subseries" hereof if Sufficient Clearing Bids do not exist.

(iii) A Bid by a Potential Owner shall constitute an irrevocable offer to purchase:

(A) the principal amount of Auction Rate Bonds of a subseries specified in such Bid if the rate determined by the Auction Procedures on such Auction Date shall be higher than the rate specified therein; or

(B) such principal amount or a lesser principal amount of Auction Rate Bonds of a subseries as described in subsection (a)(vi) of "Allocation of Auction Rate Bonds of a Subseries" hereof if the rate determined by the Auction Procedures on such Auction Date shall be equal to such specified rate.

(c) Anything herein to the contrary notwithstanding:

(i) for purposes of any Auction, any Order which specifies Auction Rate Bonds of a subseries to be held, purchased or sold in a principal amount which is not equal to the Authorized Denomination for Auction Rate Bonds of such subseries or an integral multiple thereof shall be rounded down to the nearest amount that is equal to the Authorized Denomination for Auction Rate Bonds of such subseries, and the Auction Agent shall conduct the Auction Procedures as if such Order had been submitted in such lower amount;

(ii) for purposes of any Auction other than during a daily Auction Period, any portion of an Order of an Existing Owner which relates to a Auction Rate Bond of a subseries which has been called for redemption on or prior to the Auction Date next succeeding such Auction shall be invalid with respect to such portion and the Auction Agent shall conduct the Auction Procedures as if such portion of such Order had not been submitted; and

(iii) for purposes of any Auction other than during a daily Auction Period, no portion of a Auction Rate Bond of a subseries which has been called for redemption on or prior to the Auction Date next succeeding such Auction shall be included in the calculation of Available Bonds for such Auction.

Submission of Orders by Broker-Dealers to Auction Agent

(a) Each Broker-Dealer shall submit to the Auction Agent in writing or by such other method as shall be reasonably acceptable to the Auction Agent, including such electronic communication acceptable to the parties, prior to the Submission Deadline on each Auction Date, all Orders obtained by such Broker-Dealer and, if requested, specifying with respect to each Order:

(i) the name of the Bidder placing such Order;

(ii) the aggregate principal amount of Auction Rate Bonds of each subseries, if any, that are the subject of such Order;

(iii) to the extent that such Bidder is an Existing Owner;

(A) the principal amount of Auction Rate Bonds of each subseries, if any, subject to any Hold Order placed by such Existing Owner;

(B) the principal amount of Auction Rate Bonds of each subseries, if any, subject to any Bid placed by such Existing Owner and the rate specified in such Bid; and

(C) the principal amount of Auction Rate Bonds of each subseries, if any, subject to any Sell Order placed by such Existing Owner;

(iv) to the extent such Bidder is a Potential Owner, the rate specified in such Bid.

(b) If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent shall round such rate up to the next highest one thousandth of one percent (0.001%).

(c) If an Order or Orders covering all of the Auction Rate Bonds of a particular subseries held by an Existing Owner is not submitted to the Auction Agent prior to the Submission Deadline, the Auction Agent shall deem a Hold Order to have been submitted on behalf of such Existing Owner covering the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner and not subject to Orders submitted to the Auction Agent; provided, however, that if there is a conversion from one Auction Period to another Auction Period or an amendment or modification to the Indenture as described in the section entitled "Miscellaneous Provisions Regarding Auctions" in this APPENDIX J and Orders have not been submitted to the Auction Agent prior to the Submission Deadline covering the aggregate principal amount of Auction Rate Bonds of the subseries to be converted held by such Existing Owner, the Auction Agent shall deem a Sell Order to have been submitted on behalf of such Existing Owner covering the principal amount of Auction Rate Bonds of such subseries to be converted held by such Existing Owner not subject to Orders submitted to the Auction Agent.

(d) If one or more Orders covering in the aggregate more than the principal amount of Outstanding Auction Rate Bonds of a subseries held by any Existing Owner are submitted to the Auction Agent, such Orders shall be considered valid as follows:

(i) all Hold Orders shall be considered Hold Orders, but only up to and including in the aggregate the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner;

(ii) (A) any Bid of an Existing Owner shall be considered valid as a Bid of an Existing Owner up to and including the excess of the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner over the principal amount of the Auction Rate Bonds of such subseries subject to Hold Orders referred to in paragraph (i) above;

(B) subject to clause (A) above, all Bids of an Existing Owner with the same rate shall be aggregated and considered a single Bid of an Existing Owner up to and including the excess of the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner over the principal

amount of Auction Rate Bonds of such subseries held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above;

(C) subject to clause (A) above, if more than one Bid with different rates is submitted on behalf of such Existing Owner, such Bids shall be considered Bids of an Existing Owner in the ascending order of their respective rates up to the amount of the excess of the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner over the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner subject to Hold Orders referred to in paragraph (i) above; and

(D) the principal amount, if any, of such Auction Rate Bonds of such subseries subject to Bids not considered to be Bids of an Existing Owner under this paragraph (ii) shall be treated as the subject of a Bid by a Potential Owner;

(iii) all Sell Orders shall be considered Sell Orders, but only up to and including a principal amount of Auction Rate Bonds of such subseries equal to the excess of the principal amount of Auction Rate Bonds of such subseries held by such Existing Owner over the sum of the principal amount of the Auction Rate Bonds considered to be subject to Hold Orders pursuant to paragraph (i) above and the principal amount of Auction Rate Bonds of such subseries considered to be subject to Bids of such Existing Owner pursuant to paragraph (ii) above.

(e) If more than one Bid is submitted on behalf of any Potential Owner, each Bid submitted with the same rate shall be aggregated and considered a single Bid and each Bid submitted with a different rate shall be considered a separate Bid with the rate and the principal amount of Auction Rate Bonds of such subseries specified therein.

(f) Neither the Corporation, the Trustee nor the Auction Agent shall be responsible for the failure of any Broker-Dealer to submit an Order to the Auction Agent on behalf of any Existing Owner or Potential Owner.

Determination of Auction Period Rate

(a) Not later than 9:30 a.m., New York City time, on each Auction Date for Auction Rate Bonds of each subseries in an Auction Rate Mode, the Auction Agent shall advise the Broker-Dealers and the Trustee by telephone or other electronic communication acceptable to the parties of the All Hold Rate and the Index for the Auction Rate Bonds of such subseries.

(b) Promptly after the Submission Deadline on each Auction Date for Auction Rate Bonds of each subseries in an Auction Rate Mode, the Auction Agent shall assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to as a "Submitted Hold Order," a "Submitted Bid" or a "Submitted Sell Order," as the case may be, and collectively as a "Submitted Order") and shall determine (i) the Available Bonds, (ii) whether there are Sufficient Clearing Bids, and (iii) the Auction Rate.

(c) Promptly after the Auction Agent has made the determinations pursuant to subsection (b) above, the Auction Agent shall advise the Trustee by telephone (promptly confirmed in writing), telex or facsimile transmission or other electronic communication acceptable to the parties of the Auction Rate for the next succeeding Auction Period and the Trustee shall promptly notify the Securities Depository of such Auction Rate.

(d) In the event the Auction Agent fails to calculate or, for any reason, fails to timely provide the Auction Rate for any Auction Period, (i) if the preceding Auction Period was a period of 35 days or less, the new Auction Period shall be the same as the preceding Auction Period and the Auction Period Rate for the new Auction Period shall be the same as the Auction Period Rate for the preceding Auction Period, and (ii) if the preceding Auction Period was a period of greater than 35 days, the preceding Auction Period shall be extended to the seventh day following the day that would have been the last day of such Auction Period had it not been extended (or if such seventh day is not followed by a Business Day then to the next succeeding day which is followed by a Business Day) and the Auction Period Rate in effect for the preceding Auction Period will continue in effect for the Auction Period as so extended. In the event an Auction Period is extended as set forth in clause (ii) of the preceding sentence,

an Auction shall be held on the last Business Day of the Auction Period as so extended to take effect for an Auction Period beginning on the Business Day immediately following the last day of the Auction Period as extended which Auction Period will end on the date it would otherwise have ended on had the prior Auction Period not been extended.

(e) In the event that all of the conditions for a conversion to a Fixed Rate Mode have not been met or in the event of a failure to change the length of the current Auction Period due to the lack of Sufficient Clearing Bids at the Auction on the Auction Date for the first new Auction Period, the Auction Period Rate for the next Auction Period shall be the Maximum Rate and the Auction Period shall be a seven-day Auction Period.

(f) If the Auction Rate Bonds of a subseries are not rated or are no longer maintained in book-entry form by the Securities Depository, then the Auction Period Rate shall be the Maximum Rate.

Allocation of Auction Rate Bonds of a Subseries

(a) In the event of Sufficient Clearing Bids for Auction Rate Bonds of a subseries, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for such subseries shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the Auction Rate Bonds of a subseries that are the subject of such Submitted Hold Order;

(ii) the Submitted Sell Order of each Existing Owner shall be accepted and the Submitted Bid of each Existing Owner specifying any rate that is higher than the Winning Bid Rate shall be rejected, thus requiring each such Existing Owner to sell the Auction Rate Bonds of a subseries that are the subject of such Submitted Sell Order or Submitted Bid;

(iii) the Submitted Bid of each Existing Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid;

(iv) the Submitted Bid of each Potential Owner specifying any rate that is lower than the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid;

(v) the Submitted Bid of each Existing Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Existing Owner to continue to hold the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid, but only up to and including the principal amount of Auction Rate Bonds of a subseries obtained by multiplying (A) the aggregate principal amount of Outstanding Auction Rate Bonds of a subseries which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii) or (iv) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding Auction Rate Bonds of a subseries held by such Existing Owner subject to such Submitted Bid and the denominator of which shall be the aggregate principal amount of Outstanding Auction Rate Bonds of a subseries subject to such Submitted Bids made by all such Existing Owners that specified a rate equal to the Winning Bid Rate, and the remainder, if any, of such Submitted Bid shall be rejected, thus requiring each such Existing Owner to sell any excess amount of Auction Rate Bonds of a subseries;

(vi) the Submitted Bid of each Potential Owner specifying a rate that is equal to the Winning Bid Rate shall be accepted, thus requiring each such Potential Owner to purchase the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid, but only in an amount equal to the principal amount of Auction Rate Bonds of a subseries obtained by multiplying (A) the aggregate principal amount of Outstanding Auction Rate Bonds of a subseries which are not the subject of Submitted Hold Orders described in paragraph (i) above or of Submitted Bids described in paragraphs (iii), (iv) or (v) above by (B) a fraction the numerator of which shall be the principal amount of Outstanding Auction Rate Bonds of a subseries subject to such Submitted Bid and the denominator of which shall

be the sum of the aggregate principal amount of Outstanding Auction Rate Bonds of a subseries subject to such Submitted Bids made by all such Potential Owners that specified a rate equal to the Winning Bid Rate, and the remainder of such Submitted Bid shall be rejected; and

(vii) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Winning Bid Rate shall be rejected.

(b) In the event there are not Sufficient Clearing Bids for Auction Rate Bonds of a subseries, subject to the further provisions of subsections (c) and (d) below, Submitted Orders for each Auction Bond of a subseries shall be accepted or rejected as follows in the following order of priority:

(i) the Submitted Hold Order of each Existing Owner shall be accepted, thus requiring each such Existing Owner to continue to hold the Auction Rate Bonds of a subseries that are the subject of such Submitted Hold Order;

(ii) the Submitted Bid of each Existing Owner specifying any rate that is not higher than the Maximum Rate with respect to Auction Rate Bonds of a subseries, shall be accepted, thus requiring each such Existing Owner to continue to hold the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid;

(iii) the Submitted Bid of each Potential Owner specifying any rate that is not higher than the Maximum Rate with respect to Auction Rate Bonds of a subseries, shall be accepted, thus requiring each such Potential Owner to purchase the Auction Rate Bonds of a subseries that are the subject of such Submitted Bid;

(iv) the Submitted Sell Orders of each Existing Owner shall be accepted as Submitted Sell Orders and the Submitted Bids of each Existing Owner specifying any rate that is higher than the Maximum Rate with respect to Auction Rate Bonds of a subseries, shall be deemed to be and shall be accepted as Submitted Sell Orders, in both cases only up to and including the principal amount of Auction Rate Bonds of a subseries obtained by multiplying (A) the aggregate principal amount of Auction Rate Bonds of a subseries subject to Submitted Bids described in paragraph (iii) of this subsection (b) by (B) a fraction the numerator of which shall be the principal amount of Outstanding Auction Rate Bonds of a subseries held by such Existing Owner subject to such Submitted Sell Order or such Submitted Bid deemed to be a Submitted Sell Order and the denominator of which shall be the principal amount of Outstanding Auction Rate Bonds of a subseries subject to all such Submitted Sell Orders and such Submitted Bids deemed to be Submitted Sell Orders, and the remainder of each such Submitted Sell Order or Submitted Bid shall be deemed to be and shall be accepted as a Hold Order and each such Existing Owner shall be required to continue to hold such excess amount of Auction Rate Bonds of a subseries; and

(v) the Submitted Bid of each Potential Owner specifying any rate that is higher than the Maximum Rate with respect to the Auction Rate Bonds of a subseries shall be rejected.

(c) If, as a result of the procedures described in subsection (a) or (b) above, any Existing Owner or Potential Owner would be required to purchase or sell an aggregate principal amount of Auction Rate Bonds of a subseries which is not an integral multiple of the Authorized Denomination for Auction Rate Bonds of such subseries on any Auction Date, the Auction Agent shall by lot, in such manner as it shall determine in its sole discretion, round up or down the principal amount of Auction Rate Bonds of a subseries to be purchased or sold by any Existing Owner or Potential Owner on such Auction Date so that the aggregate principal amount of Auction Rate Bonds of a subseries purchased or sold by each Existing Owner or Potential Owner on such Auction Date shall be an integral multiple of the Authorized Denomination for Auction Rate Bonds or such subseries, even if such allocation results in one or more of such Existing Owners or Potential Owners not purchasing or selling any Auction Rate Bonds of a subseries on such Auction Date.

(d) If, as a result of the procedures described in subsection (a) above, any Potential Owner would be required to purchase a principal amount of Auction Rate Bonds of a subseries that is less than the Authorized Denomination for Auction Rate Bonds of such subseries on any Auction Date, the Auction Agent shall by lot, in such manner as it shall determine in its sole discretion, allocate such Auction Rate Bonds for purchase among

Potential Owners so that the principal amount of Auction Rate Bonds of a subseries purchased on such Auction Date by any Potential Owner shall be an integral multiple of the Authorized Denomination for Auction Rate Bonds of such subseries, even if such allocation results in one or more of such Potential Owners not purchasing such Auction Rate Bonds on such Auction Date.

Notice of Auction Period Rate

(a) On each Auction Date, the Auction Agent shall notify by telephone or other telecommunication device or other electronic communication acceptable to the parties or in writing each Broker-Dealer that participated in the Auction held on such Auction Date of the following with respect to Auction Rate Bonds of each subseries for which an Auction was held on such Auction Date:

(i) the Auction Period Rate determined on such Auction Date for the succeeding Auction Period;

(ii) whether sufficient Clearing Bids existed for the determination of the Winning Bid Rate;

(iii) if such Broker-Dealer submitted a Bid or a Sell Order on behalf of an Existing Owner, whether such Bid or Sell Order was accepted or rejected and the principal amount of Auction Rate Bonds of a subseries, if any, to be sold by such Existing Owner;

(iv) if such Broker-Dealer submitted a Bid on behalf of a Potential Owner, whether such Bid was accepted or rejected and the principal amount of Auction Rate Bonds of a subseries, if any, to be purchased by such Potential Owner;

(v) if the aggregate principal amount of the Auction Rate Bonds of a subseries to be sold by all Existing Owners on whose behalf such Broker-Dealer submitted Bids or Sell Orders is different from the aggregate principal amount of Auction Rate Bonds of a subseries to be purchased by all Potential Owners on whose behalf such Broker-Dealer submitted a Bid, the name or names of one or more Broker-Dealers (and the Agent Member, if any, of each such other Broker-Dealer) and the principal amount of Auction Rate Bonds of a subseries to be (A) purchased from one or more Existing Owners on whose behalf such other Broker-Dealers submitted Bids or Sell Orders or (B) sold to one or more Potential Owners on whose behalf such Broker-Dealer submitted Bids; and

(vi) the immediately succeeding Auction Date.

(b) On each Auction Date, with respect to Auction Rate Bonds of each subseries for which an Auction was held on such Auction Date, each Broker-Dealer that submitted an Order on behalf of any Existing Owner or Potential Owner shall: (i) advise each Existing Owner and Potential Owner on whose behalf such Broker-Dealer submitted an Order as to (A) the Auction Period Rate determined on such Auction Date, (B) whether any Bid or Sell Order submitted on behalf of each such Owner was accepted or rejected and (C) the immediately succeeding Auction Date; (ii) instruct each Potential Owner on whose behalf such Broker-Dealer submitted a Bid that was accepted, in whole or in part, to instruct such Existing Owner's Agent Member to pay to such Broker-Dealer (or its Agent Member) through the Securities Depository the amount necessary to purchase the principal amount of such Auction Rate Bonds of a subseries to be purchased pursuant to such Bid (including, with respect to such Auction Rate Bonds of a subseries in a daily Auction Period, accrued interest if the purchase date is not a Distribution Date for such Auction Bond) against receipt of such Auction Rate Bonds of a subseries; and (iii) instruct each Existing Owner on whose behalf such Broker-Dealer submitted a Sell Order that was accepted or a Bid that was rejected, in whole or in part, to instruct such Existing Owner's Agent Member to deliver to such Broker-Dealer (or its Agent Member) through the Securities Depository the principal amount of such Auction Rate Bonds of a subseries to be sold pursuant to such Bid or Sell Order against payment therefor.

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(2a) The Index on any Auction Date with respect to Auction Rate Bonds of a subseries in any Auction Period of 35 days or less shall be the One Month LIBOR Rate on such date. The Index with respect to Auction Rate Bonds of subseries in any Auction Period greater than 35 days shall be the rate on United States Treasury Securities

having a maturity which most closely approximates the length of the Auction Period, as last published in The Bond Buyer. If either rate is unavailable, the Index for the Auction Rate Bonds of a subseries shall be an index or rate agreed to by all Broker-Dealers and consented to by the Corporation.

"One Month LIBOR Rate" means, as of any date of determination, the offered rate for deposits in U.S. dollars for a one-month period which appears on the Telerate Page 3750 at approximately 11:00 a.m., London time, on such date, or if such date is not a date on which dealings in U.S. dollars are transacted in the London interbank market, then on the next preceding day on which such dealings were transacted in such market.

(b) If for any reason on any Auction Date the Index shall not be determined as provided in this Section, the Index shall be the Index for the Auction Period ending on such Auction Date.

(c) The determination of the Index as provided herein shall be conclusive and binding upon the Corporation, the Trustee, the Broker-Dealers, the Auction Agent and the Owners of the Auction Rate Bonds of a subseries.

Miscellaneous Provisions Regarding Auctions

(a) In this APPENDIX J, each reference to the purchase, sale or holding of "Auction Rate Bonds" shall refer to beneficial interests in such Auction Rate Bonds, unless the context clearly requires otherwise.

(b) During an Auction Rate Mode, with respect to the Auction Rate Bonds of a subseries, the provisions of the Indenture and the definitions contained therein and described in this APPENDIX J, including without limitation the definitions of Maximum Rate, All Hold Rate, Index and the Auction Period Rate, may be modified or amended pursuant to the Indenture by obtaining, when required by the Indenture, the consent of the owners of all Outstanding Auction Rate Bonds of such subseries as follows; provided, however, that no such amendments that adversely affect the rights, duties or obligations of the Auction Agent shall be made without the consent of the Auction Agent. If on the first Auction Date occurring at least 20 days after the date on which the Trustee mailed notice of such proposed amendment to the registered owners of the Outstanding Auction Rate Bonds of a subseries as required by the Indenture, (i) the Auction Period Rate which is determined on such date is the Winning Bid Rate and (ii) there is delivered to the Corporation and the Trustee a Favorable Opinion of Bond Counsel, the proposed amendment shall be deemed to have been consented to by the owners of all affected Outstanding Auction Rate Bonds of such subseries.

(c) If the Securities Depository notifies the Corporation that it is unwilling or unable to continue as Owner of the Auction Rate Bonds of a subseries or if at any time the Securities Depository shall no longer be registered or in good standing under the Securities Exchange Act of 1934, as amended, or other applicable statute or regulation and a successor to the Securities Depository is not appointed by the Corporation within 90 days after the Corporation receives notice or becomes aware of such condition, as the case may be, the Corporation shall execute and the Trustee shall authenticate and deliver certificates representing the Auction Rate Bonds of such subseries. Such Auction Rate Bonds shall be authorized in such names and authorized denominations as the Securities Depository, pursuant to instructions from the Agent Members or otherwise, shall instruct the Corporation and the Trustee.

(d) During an Auction Rate Mode, so long as the ownership of the Auction Rate Bonds of a subseries is maintained in book-entry form by the Securities Depository, an Existing Owner or a beneficial owner may sell, transfer or otherwise dispose of an Auction Bond only pursuant to a Bid or Sell Order in accordance with the Auction Procedures or to or through a Broker-Dealer, provided that (i) in the case of all transfers other than pursuant to Auctions such Existing Owner or its Broker-Dealer or its Agent Member advises the Auction Agent of such transfer and (ii) a sale, transfer or other disposition of Auction Rate Bonds of a subseries from a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer as the holder of such Auction Rate Bonds to that Broker-Dealer or another customer of that Broker-Dealer shall not be deemed to be a sale, transfer or other disposition for purposes of this paragraph if such Broker-Dealer remains the Existing Owner of Auction Rate Bonds of a subseries so sold, transferred or disposed of immediately after such sale, transfer or disposition.

Changes in Auction Period or Auction Date

(a) *Changes in Auction Period*. (i) During any Auction Rate Mode, the Corporation may from time to time on any Auction Date, change the length of the Auction Period with respect to all of the Auction Rate Bonds of any subseries among daily, seven-days, 28-days, 35-days, three months, six months and a Special Auction Period in order to accommodate economic and financial factors that may affect or be relevant to the length of the Auction Period and the interest rate borne by Auction Rate Bonds of such subseries. The Corporation shall initiate the change in the length of the Auction Period by giving written notice to the Auction Agent, the Broker-Dealers and the Securities Depository that the Auction Period shall change if the conditions described herein are satisfied and the proposed effective date of the change, at least 10 Business Days prior to the Auction Date for such Auction Period; provided, however, that the date of such change shall be a Business Day which immediately follows the last day of an Auction Period.

(ii) Any such changed Auction Period shall be for a period of one day, seven-days, 28-days, 35-days, three months, six months or a Special Auction Period and shall be for all of the Auction Rate Bonds of a subseries in an Auction Rate Mode.

(iii) The change in the length of the Auction Period for Auction Rate Bonds of any subseries shall not be allowed unless Sufficient Clearing Bids existed at both the Auction before the date on which the notice of the proposed change was given as provided in this subsection (a) and the Auction immediately preceding the proposed change.

(iv) The change in length of the Auction Period for Auction Rate Bonds of any subseries shall take effect only if (A) the Trustee and the Auction Agent receive, by 11:00 a.m., New York City time, on the Business Day before the Auction Date for the first such Auction Period, a certificate from the Corporation consenting to the change in the length of the Auction Period specified in such certificate and (B) Sufficient Clearing Bids exist at the Auction on the Auction Date for such first Auction Period. For purposes of the Auction for such first Auction Period only, each Existing Owner shall be deemed to have submitted Sell Orders with respect to all of its Auction Rate Bonds of a subseries for which there is to be a change in the length of the Auction Period except to the extent such Existing Owner submits an Order with respect to such Auction Rate Bonds. If the condition referred to in (A) above is not met, the Auction Rate for the next Auction Period shall be determined pursuant to the Auction Procedures and the Auction Period shall be the Auction Period determined without reference to the proposed change. If the condition referred to in (A) is met but the condition referred to in (B) above is not met, the Auction Rate for the next Auction Period shall be the Maximum Rate and the Auction Period shall be a seven-day Auction Period.

(v) On the conversion date for Auction Rate Bonds of a subseries from one Auction Period to another, any Auction Rate Bonds of such subseries which are not the subject of a specific Hold Order or Bid shall be deemed to be subject to a Sell Order.

(b) *Changes in Auction Date*. During any Auction Rate Mode, the Auction Agent, with the written consent of the Corporation, may specify an earlier Auction Date for Auction Rate Bonds of any subseries (but in no event more than five Business Days earlier) than the Auction Date that would otherwise be determined in accordance with the definition of "Auction Date" in order to conform with then current market practice with respect to similar securities or to accommodate economic and financial factors that may affect or be relevant to the day of the week constituting an Auction Date and the interest rate borne on such Auction Rate Bonds. The Auction Agent shall provide notice of its determination to specify an earlier Auction Date for an Auction Period by means of a written notice delivered at least 45 days prior to the proposed changed Auction Date to the Trustee, the Corporation, the Broker-Dealers and the Securities Depository.

Auction Agent

(a) The Auction Agent shall be appointed by the Trustee at the written direction of the Corporation, to perform the functions specified herein. The Auction Agent shall designate its Principal Office and signify its acceptance of the duties and obligations imposed upon it hereunder by an Auction Agreement delivered to the Corporation, the Trustee and each Broker-Dealer which shall set forth such procedural and other matters relating to the implementation of the Auction Procedures as shall be satisfactory to the Corporation and the Trustee.

(b) Subject to any applicable governmental restrictions, the Auction Agent may be or become the owner of or trade in Auction Rate Bonds with the same rights as if such entity were not the Auction Agent.

Qualifications of Auction Agent; Resignation; Removal

The Auction Agent shall be (a) a bank or trust company organized under the laws of the United States or any state or territory thereof having a combined capital stock, surplus and undivided profits of at least $30,000,000, or (b) a member of National Association of Securities Dealers having a capitalization of at least $30,000,000 and, in either case, authorized by law to perform all the duties imposed upon it by the Indenture and a member of or a participant in, the Securities Depository. The Auction Agent may at any time resign and be discharged of the duties and obligations created by the Indenture by giving at least ninety (90) days notice to the Corporation, each Broker-Dealer and the Trustee. The Auction Agent may be removed at any time by the Corporation by written notice, delivered to the Auction Agent, each Broker-Dealer and the Trustee. Upon any such resignation or removal, the Trustee shall appoint a successor Auction Agent meeting the requirements of this Section. In the event of the resignation or removal of the Auction Agent, the Auction Agent shall pay over, assign and deliver any moneys and Auction Rate Bonds held by it in such capacity to its successor. The Auction Agent shall continue to perform its duties hereunder until its successor has been appointed by the Trustee. In the event that the Auction Agent has not been compensated for its services, the Auction Agent may resign by giving thirty (30) days notice to the Corporation and the Trustee even if a successor Auction Agent has not been appointed.

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APPENDIX K

PROPOSED FORM OF OPINION OF BOND COUNSEL

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APPENDIX K

PROPOSED FORM OF OPINION OF BOND COUNSEL

[LETTERHEAD OF HAWKINS, DELAFIELD & WOOD]

_____, 2003

Tobacco Settlement Financing Corporation
New York, New York

Members:

As Bond Counsel to the Tobacco Settlement Financing Corporation (the "Corporation"), a public benefit corporation of the State, established as a subsidiary of the State of New York Municipal Bond Bank Agency and created and empowered to effectuate the purposes of the Tobacco Settlement Financing Corporation Act (the "Act"), we have examined the Constitution and laws of the State of New York (the "State") and a record of proceedings relating to the issuance of its $2,240,415,000 aggregate principal amount of Asset-Backed Revenue Bonds, Series 2003B (State Contingency Contract Secured) (the "Series 2003B Bonds").

In such examinations, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals and the conformity with originals of all documents submitted to us as copies thereof.

The Series 2003B Bonds are authorized and issued pursuant to the Act and a resolution of the Corporation adopted November 6, 2003, and are issued pursuant to an indenture and series supplement thereto, each by and between the Corporation and The Bank of New York as trustee (the "Trustee"), and each dated as of December 1, 2003 (together, the "Indenture"). The Corporation is authorized and has reserved the right to issue one or more additional series of bonds for refunding purposes, secured on a parity with the Series 2003B Bonds, only on the terms and conditions set forth in the Indenture.

Capitalized terms used herein and not defined herein are used as defined in the Indenture.

In rendering our opinion, we have relied, to the extent we have deemed such reliance proper, on certain representations, certifications of fact, and statements of reasonable expectation made by the Corporation and the State in connection with the issuance of the Series 2003B Bonds, and certain opinions provided to us, and we have assumed compliance by the Corporation and the State with certain ongoing covenants to comply with applicable requirements of the Internal Revenue Code of 1986, as amended (the "Code"), to assure the exclusion of the interest on the Series 2003B Bonds from gross income under Section 103 of the Code.

The Series 2003B Bonds are secured by a pledge of the Contingency Contract dated as of December 1, 2003 by and between the State of New York, acting by and through the Director of the Budget, and the Corporation (the "Contract"), which provides for payments by the State of New York to the Corporation, subject to annual appropriation by the State Legislature, in the event that all other pledged funds (the "Collateral") under the Indenture are not sufficient to pay debt service on the Series 2003B Bonds. We have relied upon the opinion of the Attorney General as to the enforceability of each of the Purchase and Sale Agreement and the Contract against the State and upon the opinion of Stadtmauer Bailkin LLP as to the enforceability of the Indenture against the Trustee, each in accordance with its respective terms.

We undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Series 2003B Bonds and express no opinion with respect thereto.

Subject to the foregoing, we are of the opinion that:

1. Under the laws of the State, including the Constitution of the State, and under the Constitution of the United States, the Act is valid with respect to all provisions thereof material to the subject matters of this opinion letter.

2. The Corporation is duly created and established and validly exists under the Act as a public benefit corporation of the State, with the right and lawful authority and power to enter into the Indenture, the Contract and the Purchase and Sale Agreement, to perform the duties and obligations of the Corporation under the Indenture, the Contract and the Purchase and Sale Agreement, and to issue the Series 2003B Bonds.

3. Each of the Purchase and Sale Agreement, the Contract and the Indenture has been duly and lawfully authorized, executed and delivered by the Corporation, is in full force and effect and is the legal, valid and binding agreement of the Corporation, enforceable against the Corporation in accordance with its terms.

4. The Indenture creates the valid pledge of, and first-priority lien on, the Collateral (including, without limitation, Pledged Revenues received under the Contract and the Purchase and Sale Agreement) that it purports to create. Pursuant to the Act, the lien of such pledge and security interest is valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Corporation, irrespective of whether such parties have notice thereof.

5. The claim of the Trustee (as assignee and pledgee of the Corporation) upon the right, title and interest to Pledged Settlement Payments is valid and enforceable and on a parity with (i) the claim of the State to Unsold Settlement Payments, and (ii) the claim of trustee for the Corporation's Asset-Backed Revenue Bonds, Series 2003A (State Contingency Contract Secured), dated June 19, 2003, to Previously Purchased and Pledged Settlement Payments.

6. The Series 2003B Bonds have been duly and validly authorized and issued by the Corporation in accordance with provisions of the Act and the Indenture and are valid and binding special revenue obligations of the Corporation, payable only out of the Collateral pledged by the Corporation under the Indenture in Section 2.01 thereof.

7. Pursuant to the Act, no Series 2003B Bond shall constitute a debt or moral obligation of the State or a State supported obligation within the meaning of any constitutional or statutory provision or a pledge of the faith and credit of the State or of the taxing power of the State, and the State shall not be liable to make any payments thereon nor shall any Series 2003B Bond be payable out of any funds or assets other than the Collateral pledged therefor.

8. Under existing statutes and court decisions, interest on the Series 2003B Bonds (i) is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Code, and (ii) is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, however, is included in adjusted current earnings of certain corporations for purposes of computing the alternative minimum tax imposed on such corporations.

9. Under the Act, interest on the Series 2003B Bonds is exempt from personal income taxes imposed by the State and its political divisions, including The City of New York.

We express no opinion regarding any other tax consequences with respect to the Series 2003B Bonds. We render our opinions under existing statutes and court decisions as of the date hereof, and we assume no obligation to update our opinions after such date to reflect any future action, fact or circumstances, or change in law or interpretation, or otherwise. Except to the extent of our concurrence therewith, we express no opinion on the effect of any action taken or not taken after the date of our opinion in reliance on an opinion of other counsel on the exclusion from gross income for federal income tax purposes of the interest on the Series 2003B Bonds.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2003B Bonds, the Indenture and the Purchase and Sale Agreement may be limited 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).

Very truly yours,

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